

# PHILIPS

## Annual Report 2001 Management Report



Philips has embarked upon a process of transformation designed to position the company for the digital world of the 21st century. We are committed to working together to deliver the innovative products, applications and technologies that will allow our customers to enjoy the best the future has to offer.

One of our latest and most appealing products in the display area is a full-featured computer monitor with the addition of complete TV functionality, the 150MT LCD Monitor/TV shown on the cover. This product is the result of leveraging our leadership in high-performance computer display devices and cutting-edge television innovations. It operates like any other PC monitor in displaying normal applications such as word processing, Internet browsing and e-mail. But, when switched to TV mode, it enables you to watch the latest news or any other TV program. A DVD player or VCR can also be connected. The resizable picture-in-picture feature even allows you to work on the PC while watching TV in a separate window.

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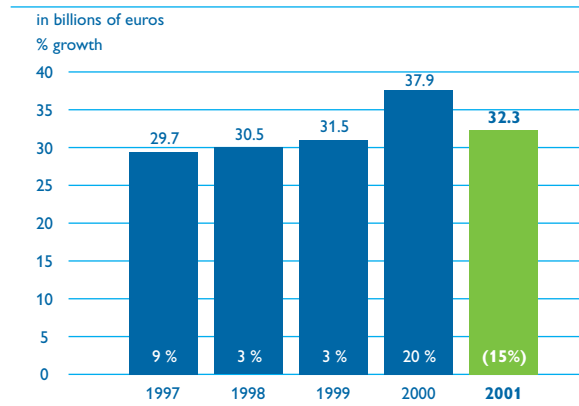
### 'Safe Harbor' Statement under the Private Securities Litigation Reform Act of 1995

This document contains certain forward-looking statements with respect to the financial condition, results of operations and business of Philips and certain of the plans and objectives of Philips with respect to these items, in particular the outlook paragraph of the 'Report on the performance of the Philips Group' in this Management Report booklet. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements. These factors include, but are not limited to, levels of consumer and business spending in major economies, changes in consumer tastes and preferences, the levels of marketing and promotional expenditures by Philips and its competitors, raw materials and employee costs, changes in future exchange and interest rates (in particular changes in the euro and the US dollar can materially affect results), changes in tax rates and future business combinations, acquisitions or dispositions and the rate of technical changes. Market share estimates contained in this report are based on outside sources such as specialized research institutes, industry and dealer panels, etc. in combination with management estimates.

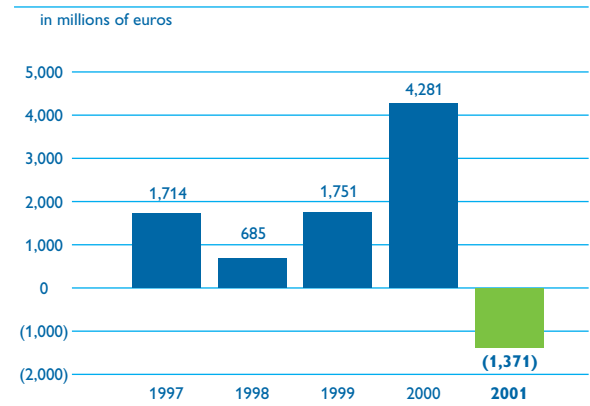
This Management Report and the separate booklet entitled 'Financial Statements and Analysis' together comprise the full Annual Report for the year 2001 of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics'). This Management Report contains a summary of the Operating and Financial Review and Prospects entitled 'Report on the performance of the Philips Group'. The selected financial information included in this Management Report is derived from the Philips Group's full annual financial statements including notes. The Financial Statements and Analysis booklet also contains additional financial information and further statutory and other information. For a full understanding of the results of the Group and the state of affairs, both booklets should be consulted.

# Graphs

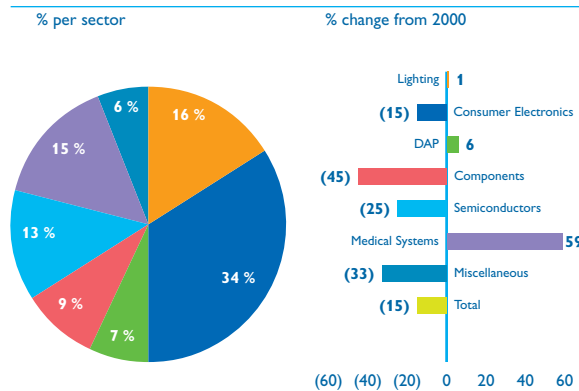
## Sales



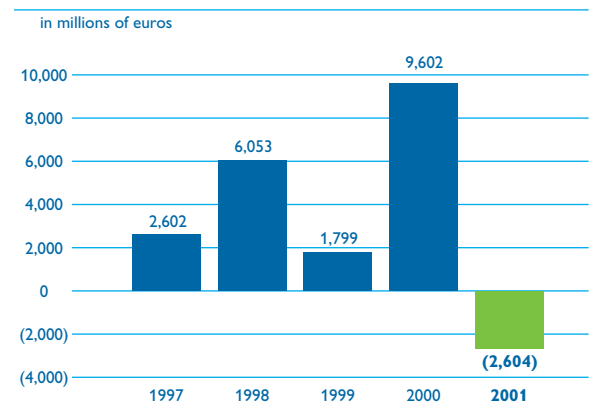
## Income (loss) from operations



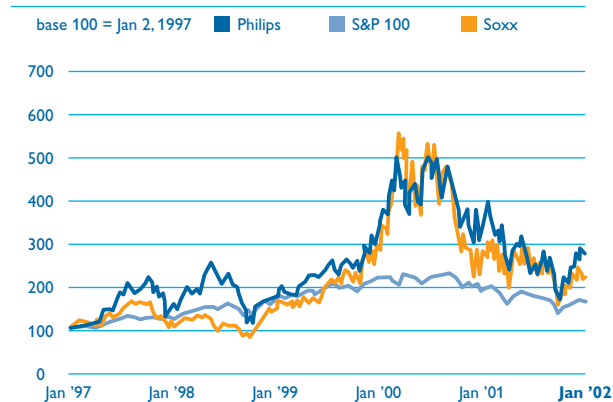
## Sales per sector



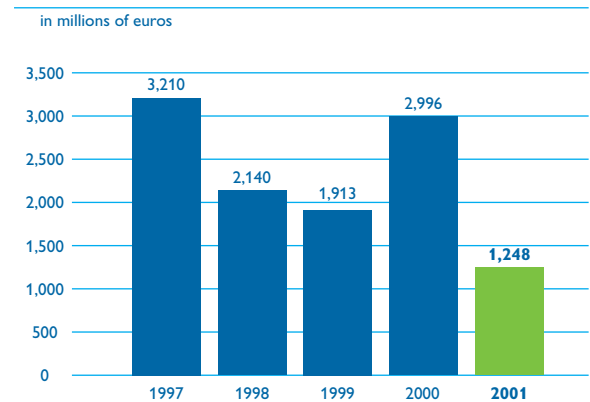
## Net income (loss)



## 5-year relative performance: Philips, S&P 100, Soxx



## Cash flows from operating activities



## Financial highlights

all amounts in millions of euros unless otherwise stated

	2001	2000
Sales	32,339	37,862
Income (loss) from operations	(1,371)	4,281
As a % of sales	(4.2)	11.3
As a % of net operating capital (RONA)	(9.1)	35.7
Net income (loss)	(2,604)	9,602
Per common share - basic	(2.04)	7.31
Dividend paid per common share (from prior-year profit distribution)	0.36	0.30
Cash flows before financing activities	(3,316)	592
Stockholders' equity	18,453	21,736
Per common share	14.48	16.93
Net debt : group equity	27:73	12:88
<b>Excluding special items*:</b>		
Income (loss) from operations	(136)	3,211
As a % of sales	(0.4)	8.5
As a % of net operating capital (RONA)	(0.9)	26.8
Net income (loss)	(908)	2,831
Per common share - basic	(0.71)	2.16

\* Special items relate to income and expenses resulting from normal business operations, which, because of their size or nature, are disclosed separately to give a better understanding of the underlying result for the period. These include items such as restructuring and impairment charges, acquisition-related charges and significant gains and losses on the disposal of businesses or participations.

## Message from the President





## Dear Shareholder,

It was heavy going for Philips in 2001. We were affected by the general economic downturn that first manifested itself in the dot.com industry and then spread out to engulf a substantial part of the technology sector, especially the mobile telecom and IT-related industries; this downturn was exacerbated by the dramatic events of September 11 in the US. Our Semiconductors, Components and Consumer Electronics (CE) businesses were particularly hard hit. Semiconductors and Components, for instance, supply parts to many of the major mobile phone manufacturers and PC peripherals suppliers, so the stagnation in those markets was sorely felt.

Our other divisions – Lighting, Domestic Appliances and Personal Care (DAP) and Medical Systems – were, as a whole, only marginally impacted by the economic cycle and continued to deliver an encouraging performance, with record operating profits for DAP and for Medical Systems before acquisition-related charges.

Overall, Group sales fell 15%, contributing to a net loss of EUR 2,604 million. This figure includes special charges of EUR 2,007 million and gains of EUR 311 million. Excluding these items, the net loss came to EUR 908 million.

The loss is disappointing as it is due not only to the adverse economic environment, but also to operational issues in some parts of our organization, notably in the areas of innovation to market and supply chain management – a clear indication that we still have a lot of work to do.

On a positive note, our operational cash flow was EUR 1.2 billion positive, notwithstanding the negative net income, thanks to focused working capital management, including a sharp reduction in inventories. Another encouraging development was the performance of our share price. During the early part of the year our share price declined, as did other technology stocks, and then was substantially negatively impacted in the second half of September. Since this time, we have seen a significant recovery and over the whole year our relative performance against our peers has been good. Also over a longer period of 2 to 3 years we see a good relative performance against our peers.

## Early response

Before the global economic downturn became evident, Philips had already initiated a number of reforms to deal with pressing short-term issues, such as underperforming activities, and to establish the foundations for long-term sustainable growth. Early in the year we took steps to cut costs, manage inventories downward and reduce capital spending. We also tackled the loss-making mobile handset business at Philips Consumer

Communications (PCC), transferring the manufacturing and part of the R&D to a partnership with China Electronics Corporation (CEC). This approach means that we will continue to sell Philips branded mobile phones, while now benefiting from lower (and mostly variable) costs, a reduced asset base and significantly diminished risks as well.

Corrective action was also taken at Digital Networks. Our set-top box business in the USA, for example, has limited its platform diversity and is giving priority to profitability rather than market share. At Semiconductors and Components, capacity was adjusted to cope with reduced demand, and a number of older, less efficient production lines were closed.

As the economic weakness in many of our markets continued, we took further measures designed to cut overhead costs by 25% (EUR 300 million), e.g. by lowering spending on consultancy and sponsorship and, more fundamentally, by changing the way we work as a company – cutting back bureaucracy and, wherever possible, sharing internal resources.

### Facing the facts

It would be too easy to attribute all our problems to the general economic situation. Despite the excellent year we had in 2000, several problems were already beginning to surface. Some of our processes are not up to benchmark standard, our fragmented organization makes us carry too high costs for infrastructure and overhead, and we've allowed too many low-growth, low-margin businesses to develop. They account for an unacceptably high percentage of our total portfolio. Consumer Electronics, for instance, which accounts for around a third of Group sales, hasn't been performing well enough for several years. Though parts of CE enjoy good returns and have strong market positions, especially in Europe, other areas – notably US operations – are in need of fundamental reform. We are addressing this. In the US, for instance, we have revamped our product mix, installed a new management team and reallocated production to reduce the cost base. In the consumer electronics business, product innovation, customer intimacy and strong brand and channel management are key success drivers. Accordingly, CE is intensifying its customer and market focus. Technology leadership will be secured in critical areas through effective cooperation with Semiconductors and Components. In some production activities where we cannot add value, we will let others do it for us and outsource.

During the year, for instance, we arranged to outsource the manufacturing of our VCRs to Funai Electric of Japan and, as mentioned above, transferred the production of our mobile handsets to CEC. We also merged our cathode-ray tube activities with those of LG Electronics of South Korea. Although these products can still generate substantial income for





us in years to come – the joint venture's market position in tubes is very strong – the real future of displays lies with newer technologies such as LCD. Production outsourcing of mature technology lines, or partnering with other companies, will allow us to still extract benefit from remaining growth and high volumes while we develop new cutting-edge technologies and products with the potential to deliver significantly higher margins.

### Strategic focus

In 2001 we pushed ahead with a review of the Group's strategy, brand positioning and company values, the objective being to create an even more dynamic, customer-driven organization in which all the parts work together to fully exploit the Group's powerful technology base, its research and development strengths, its market positions and its ability to operate globally.

With the growing consumer demand for entertainment, information and communications, any successful strategy for digital electronics will have to be centered around three major developments: digitalization, convergence and Internet pervasiveness. We are ideally placed to be a leading player in the digital age of the Internet, just as we took the lead a century ago at the beginning of the electrical age. We have the expertise in-house:

- optical storage on DVD, with rewriting capability;
- digital video, through our Nexperia digital video platform;
- wireless technologies such as Bluetooth for connectivity with other products and networks, including the Internet;
- and display technologies and applications, such as one-chip TV ICs, LCD TV, projection TV, Liquid-Crystal-on-Silicon mini-displays, polymer light-emitting displays and flexible displays.

The technological foundation required to enable us to pursue our high-growth ambitions is therefore largely in place – now what remains is for us to demonstrate the entrepreneurship and drive needed to unlock all this fantastic potential.

### Marketing and branding

Several times in the past we have failed to reap the benefit of our early investments in technology. For some time our marketing has not been up to standard in many areas. Accordingly, we've taken steps to upgrade the whole marketing function throughout the Company, including the appointment of Chief Marketing Officers in our major divisions. We will also be tightening the consistency of the 'Philips brand experience', so that those who buy and use our products will recognize them clearly as being from us. It's a question of design, a shared look and feel – and the fact that our products show that we understand what people want from technology. To this end we will roll out, in the first quarter of 2002, a newly defined brand platform that clearly defines our positioning.

### Strength through cooperation

In order to become a leader in digital-age technology, our product divisions are going to have to work more closely together. The technologies are converging, and consumers tell us they no longer see any real division between technology for the home, for work and for on the move. It's just technology for people. Our divisions grew up historically on the basis of separate technologies. Those boundaries are less relevant today and hold us back rather than help us work more efficiently.

Our product divisions have many shared interests. For instance, solid-state technologies within Lighting are linked with our screen display activities at Components. Certain types of medical equipment are becoming consumer items, implying a link between Medical Systems and Personal Care, while for Liquid-Crystal-on-Silicon projection technology, you need semiconductors, components and lighting expertise. Just as companies are increasingly finding that they need to enter into alliances and partnerships, so we need to establish more effective networks and partnerships within the Company. Bringing people together is the key. One very good example of this was the introduction of the DVD recorder last August: thanks to outstanding cooperation between several divisions, we were able to bring this product to market six months ahead of schedule and, more importantly, ahead of our competitors. This is the way we have to go, working together, sharing best practices and resources, and concentrating on seizing the opportunities of the future.

### Gearing up for the future

So how do I see the Company developing in the next few years? I see Research, Semiconductors, Components and the digital parts of Consumer Electronics as forming the heart of our high-growth technology engine. Medical Systems' multi-billion dollar acquisitions program has made the division a true high-tech powerhouse (its acquisitions in 2001 of Agilent Healthcare Solutions Group and Marconi's Medical Systems have already made it No. 2 in the world in medical digital imaging equipment). Further growth will be driven by building our service business and by our foray into home telemedicine. Around this core we have Lighting and DAP – cash-generating businesses which to a large extent are operating in more mature markets and are less impacted by the economic cycle. In the case of Lighting, also a world leader, new growth will be stimulated by emerging technologies, such as solid-state lighting (LEDs), and a strong focus on lighting-related electronics. Finally, growth at DAP will center mainly on male shaving and oral healthcare.

By increasing our focus on value creation from a *total company perspective*, e.g. through cross-divisional programs in technology management and marketing, we will energetically pursue our declared corporate objectives of generating sustainable profit growth and maximizing shareholder value through product and market leadership. To this end, we reaffirm our

commitment to the medium-term financial targets that serve as the performance benchmarks for our transformation into a high-growth technology company: sales growth of 10% on average per year, growth of earnings per common share of 15% on average per year, IFO margin above 10% and a positive cash flow.

### The Philips Way

However, the Company as a whole has to work with a shared sense of purpose and motivation if we're to be successful. A clear recommitment to the values that have sustained Philips' pioneering position for over a century is also a priority as we move to unlock the Company's potential. Accordingly, we have decided to introduce a new expression of our company values – *Delight customers, Deliver on commitments, Develop people, Depend on each other* – which will be rolled out in the first quarter of 2002. These values, together with the Philips brand platform, represent an important element in defining the identity and focus of the 21st century Philips – what the Company stands for, where it is heading, and, most importantly, how it is going to get there.

Flexibility and speed continue to be vital. To make sure we develop in this area, we'll be continuing with the implementation of our BEST (Business Excellence through Speed and Teamwork) program. BEST is designed to spread management best practice across the Group and so support our goal of achieving world-class performance in our processes, fostering teamwork and cohesion.

### Final thoughts

On a personal note, I would like to thank my fellow Board member John Whybrow, who will be retiring this year, for his dedicated service and outstanding contribution to the Company over a period of 30 years. I wish him all the best for his retirement.

Finally, I would like to thank you, our shareholders, for keeping faith with Philips over this last, difficult year. I can assure you that we in the Board of Management will do everything necessary to chart a course that enables Philips to continue its tradition of innovation and entrepreneurship in the 21st century and to be a major force in the digital era. And I know that in doing so I can count on the dedication and drive that our employees have demonstrated so often in the past to help us fulfil the promise of the future.

A handwritten signature in black ink, appearing to read 'G. Kleisterlee', with a long horizontal stroke extending to the right.

Gerard Kleisterlee, *President*

The foundations for this dynamic corporation were laid in 1891, when Gerard Philips established a company in Eindhoven, the Netherlands, to 'manufacture incandescent lamps and other electrical products'. Gerard and his brother Anton were entrepreneurs who succeeded in business by delivering innovations that improved the lives of their customers and employees.

The company initially concentrated on making carbon-filament lamps, and by the turn of the century was one of the largest producers in Europe. Developments in new lighting technologies fueled a steady program of expansion, and in 1914 it established a research laboratory.

Philips began early to protect its innovations with patents, in areas such as X-ray radiation and radio reception. This marked the beginning of diversification. Having introduced a medical X-ray tube in 1918, Philips then became involved in the first experiments in television in 1925. It began producing radios in 1927 and had sold one million by 1932. Thus was born a tradition of bringing meaningful technology innovations to market at the right time.

Displaying the tenacity, curiosity and imagination of the true pioneer, Philips continued to break new ground over the following decades: inventing the rotary heads which led to the development of the Philipsave, for instance, and carrying out pioneering work on transistors and integrated circuits.

- Philips' annual production of tubular fluorescent lamps laid end to end would stretch around the world more than six times.

- Philips introduced the world's first multichannel Super Audio CD player.

- Philips LCD panels are used in the NASA space shuttle.



### Lighting

- Lamps
- Luminaires
- Lighting Electronics
- Automotive & Special Lighting

### Consumer Electronics

- Mainstream CE
- Digital Networks
- Consumer Communications
- Licenses

### Domestic Appliances and Personal Care

- Male Shaving & Grooming
- Body Beauty & Health
- Oral Healthcare
- Food & Beverage
- Home Environment Care

And the flow of exciting new products and ideas continued: the compact audio cassette in 1963, for example, energy-saving lamps, and key breakthroughs in the processing, storage and transmission of images, sound and data, resulting in the invention of e.g. the LaserVision disc, the Compact Disc and optical telecommunication systems.

The rapid mass acceptance of DVD, the CD's successor format, illustrates how important it is for a company to understand how people experience technology. People interact with technology practically every second, often without even realizing it. Only by appreciating how these interactions take place can we enhance our

customers' experience of them. Today, with the digital revolution in full swing, we must listen to – and learn from – our customers, and then create the products and systems that will delight tomorrow's consumers, always mindful of the social, environmental and economic impact of the choices we make.

- *More than 50% of the world's color TVs are powered by Philips Semiconductors*

- *More than half the world's cardiac X-ray procedures are performed on Philips diagnostic imaging equipment.*

- *Philips Research generates 4 new patents every day.*



## Components

- Optical Storage
- Mobile Display Systems
- Emerging Electronic Solutions
- Connectivity

## Semiconductors

- Discretes & Multimarket ICs
- Digital Consumer Systems
- Display Solutions
- Mainstream Consumer Systems
- Mobile Consumer Systems
- Mobile Communications
- Networking
- Identification
- Emerging Businesses

## Medical Systems

- X-Ray Equipment
- Computed Tomography
- Magnetic Resonance
- Ultrasound
- Nuclear Medicine
- Imaging IT
- Healthcare Services
- MedQuist



# Leading light

*Philips Lighting holds the No. 1 position in the global lighting market. This position is supported by leadership in innovation combined with continuing cost and efficiency improvements and a systematic approach to seeking out new market opportunities for our lines of business: Lamps, Luminaires, Lighting Electronics and Automotive & Special Lighting. Major drivers for growth are: innovative products based on technology breakthroughs; the grasping of opportunities in emerging regions; and focus on value creation through marketing excellence. Across Europe, North America, Latin America and Asia Pacific the division employs some 48,000 people.*

**Our strategic ambition is to set the pace in the lighting industry as the first-choice innovative partner for the supply of creative and cost-effective lighting solutions. Marketing excellence and improved customer service are, along with innovation, the three cornerstones of our business going forward.**

**Besides innovative products, Philips Lighting continues its focus on innovative ways of doing business. A pioneer in the field of e-business, we now have fully integrated activities on both the sell-side and the buy-side, with product information provided through websites and e-catalogs. We have developed order entry / order status extranets throughout the world. And, in collaboration with partners, we are leading the development of e-marketplaces.**



## The benefits of innovation

Within Lamps, our largest business, the main growth areas are the thin 16 mm T5 fluorescent lamps, halogen and high-intensity discharge lamps – especially Mastercolor CDM. The latter solve the color variation problems inherent in conventional metal-halide lamps, while offering much longer economic life and thus considerably lower maintenance costs.

In Luminaires we have been vigorously implementing a change program to increase efficiency and improve profitability. Among many product introductions, our efforts to help make the city more beautiful as well as safer at night have continued with the introduction of our New Metronomis range, offering lighting designers, architects and urban planners a complete tool box for lighting the city.



### Beauty by night

For the first time since its completion in 1674, the beauty of the Chateau of Versailles is permanently visible by night thanks to the use of over 500 energy-saving lighting sets. The Palace takes its place amongst some of the world's most recognizable landmarks that Philips Lighting has illuminated. Others include Tower Bridge in London, the Taj Mahal, the Eiffel Tower and the Sphinx at Giza, Egypt.



### Bulb that lasts vehicle's entire service life

Our HiPerVision signaling bulb offers a lifetime matching that of the car. And, because of its small size, it opens up opportunities for designers of new car models, while bringing end-user benefits such as increased trunk space. Daimler Chrysler, Philips' partner from the early development stage, is applying this technology in its latest E-Class Mercedes. In Mercedes trials, the new development proved its worth over a distance of more than 850,000 kilometers without showing any signs of a defect. That equates to twelve times the service life of conventional bulbs.



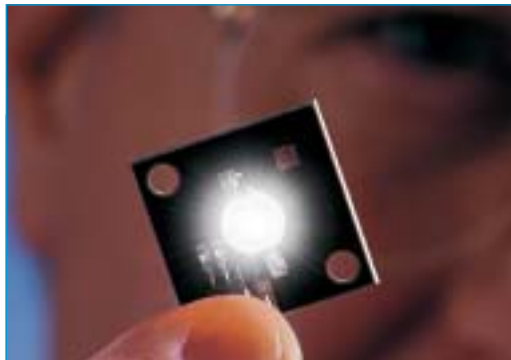
### Efficiency through electronics

In Lighting Electronics, the potential our technology offers in terms of energy saving, miniaturization, increased power and flexibility, and cost effectiveness has led us to create a new global business unit, Special Lighting Electronics, focusing on electronics for e.g. UHP (Ultra High Performance) lamps, LEDs and automotive and solar applications. Through the acquisition of the fluorescent lighting ballast operation of Lumisistemas (Mexico) and the lighting ballast activities of Helfont (Brazil), we have consolidated our leading position in these markets. The launch of the eKyoto ballast in Europe provides an attractive, economical alternative to electromagnetic ballasts, offering substantial energy savings and therefore also making things better for the environment.

derably enhance safety on the roads. In Special Lighting – applications such as digital data projection (where we have the leading position with our UHP lamp), stage/theater/entertainment, infrared for industrial use, and ultraviolet for both solar and air/water disinfection – we continue to focus on exploiting double-digit growth opportunities in new application areas. We recently formed a joint venture with the Fraunhofer Institute in Aachen, Germany, to develop Extreme UV light sources to be mounted in the next generation of photolithography equipment for the semiconductor industry.

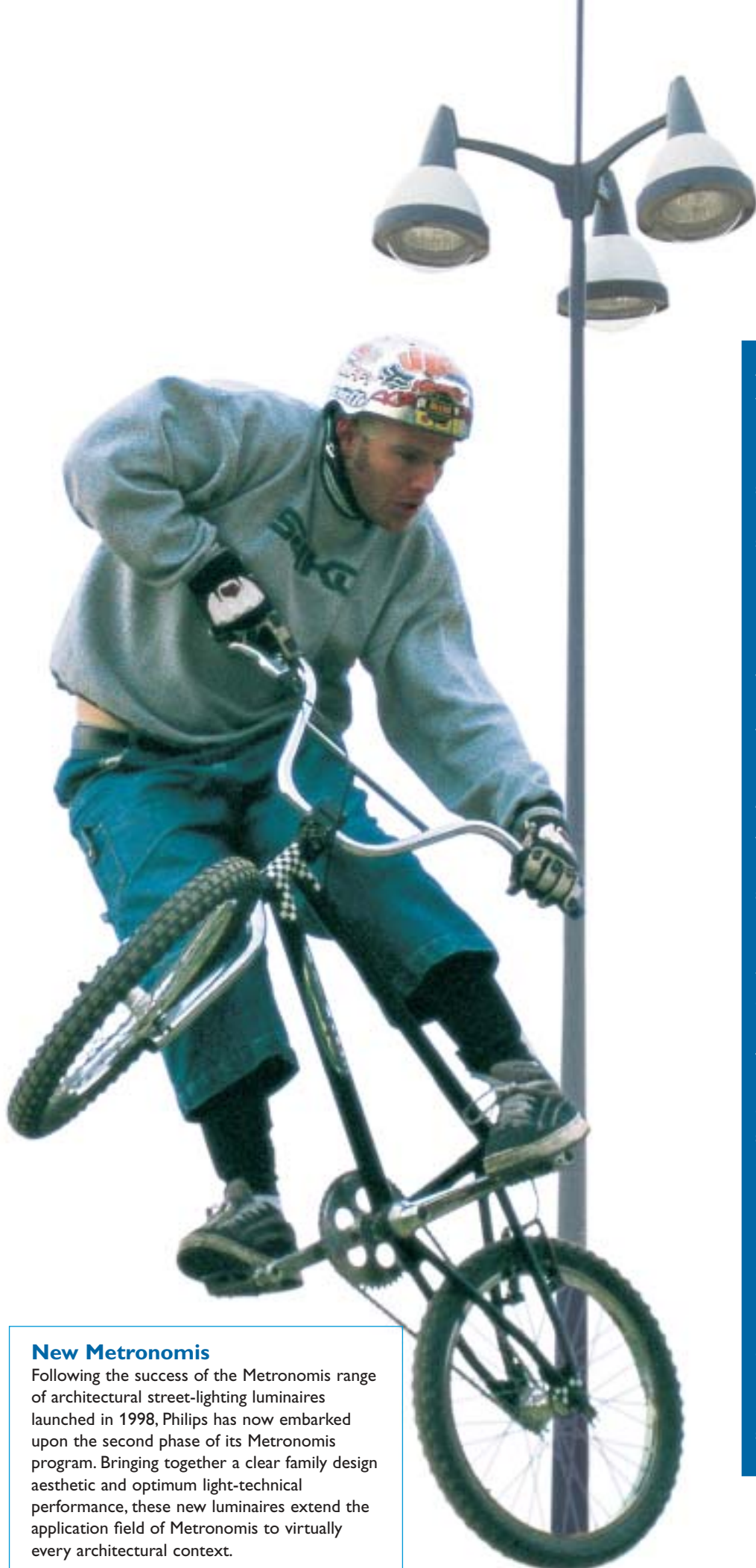
### The road ahead

In Automotive, fast growth is driven by our innovations enhancing comfort and safety on the road. Our VisionPlus replacement headlight bulbs, for instance, give up to 50% more light on the road. In 2001 we produced our ten millionth Xenon bulb; US research has shown that Xenon lights consi-



#### Quantum leap

In LumiLeds Lighting, our joint venture with Agilent Technologies in the field of LEDs (Light-Emitting Diodes), sales continue to extend from automotive and traffic signal applications into signage and contour lighting. New applications for LCD backlighting are opening up based on the rapid, ongoing improvement of the technology. The new Luxeon LED technology, which lasts 100 times longer and is up to four times more efficient than today's standard incandescent light sources, was launched to widespread acclaim in the marketplace.



### New Metronomis

Following the success of the Metronomis range of architectural street-lighting luminaires launched in 1998, Philips has now embarked upon the second phase of its Metronomis program. Bringing together a clear family design aesthetic and optimum light-technical performance, these new luminaires extend the application field of Metronomis to virtually every architectural context.

## As bright as the sun

Projection technology has become a very important display technology, not only for data front projectors but also for home cinema systems. Breakthroughs in display panel and projection lamp technologies have been key to this development. The UHP (Ultra High Performance) lamp, with brightness matching that of the sun, is a patented Philips invention, which has made Philips Lighting the industry leader in such projection lamps.

Thanks to this UHP technology, which has been developed in close cooperation with Philips Research and other partners including Philips Creative Display Solutions, the whole meeting room environment has been transformed. No more bulky overhead projectors, but interactive presentations with moving images from portable multimedia projectors. Further cooperation, also with outside partners, is aimed at enabling affordable home cinema systems with crystal-clear pictures through e.g. polysilicon LCDs or Philips Components' Liquid-Crystal-on-Silicon technology.

So far, research and cooperation with both internal and external partners have improved the system light output by a factor of 10, while reducing the size and weight of the system by a factor of more than 10, all in less than six years.

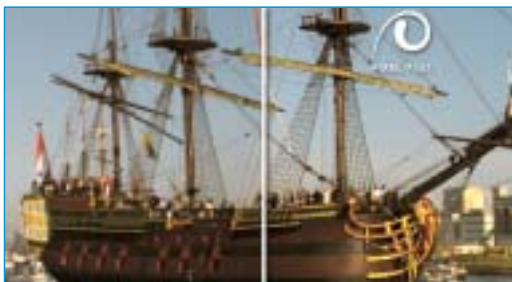


# Going digital

*As the world's No. 3 company in the field of consumer electronics, Philips Mainstream Consumer Electronics is focusing on three main areas: digital displays; digital recording and playback; and (wireless) connectivity and the Internet. By year-end 2001, Philips Mainstream Consumer Electronics had a headcount of around 20,000.*

**Given the growth opportunities for digital in our key focus areas, we are continuing to drive forward our move from analog into digital. This is reflected in the composition of and changes to our product portfolio. The DVD recorder we introduced in 2001, for instance, illustrates our commitment to digital storage and forms a strong foundation for the future. In the analog domain, on the other hand, we focus on managing our business with maximum profitability by minimizing assets (increased outsourcing) and reducing product diversity and development costs. For example, with the market for analog video recorders becoming mature, we decided to outsource production to Funai Electric Company, Ltd. of Japan and to concentrate our VCR resources on marketing and sales.**

**We enjoy a leading market position in product categories such as television, PC monitors, CD, audio and DVD playback thanks to our lifestyle products, in which design and ease of use play a decisive role. This match between consumer desires and our product offering can only be achieved by listening to consumers, identifying their needs and applying the best available technology to meet them.**



## **PixelPlus**

Delivery platforms such as digital broadcasting, DVD-Video, games and interactive services are placing increasingly heavy demands on the picture performance capabilities of conventional television technologies. Drawing on its extensive capabilities in digital signal processing, Philips has introduced PixelPlus, which delivers unparalleled depth of detail, sharpness and resolution, with no visible line structure, for both moving and still images. PixelPlus will be incorporated in an exciting new design range of TV sets in 2002.

## **Digital displays**

In consumer display devices, our focus is on the overall viewing experience, the trend being towards flat, slim and wide, with increased emphasis on picture quality and design. New technologies are on the short-term horizon. We are currently working on PixelPlus technology, which enables us to double screen resolution, the latest milestone in picture quality. The result: a high-definition picture in a conventional TV set, dramatically increasing viewing pleasure.

In 2000 we introduced LightFrame, a proprietary technology for TV-quality video and photo display on a computer monitor. This combination of monitor hardware and PC-based software boosts the brightness and sharpness of a monitor's video signal. In the course of 2001 this technology was further improved for significantly better web performance.



### Digital recording

After the successful launch of the consumer CD audio recorder, the DVD recorder is the next important building block in the digital domain. Our well-received DVD-Video player needed only one addition: the red recording button. Recordings made on a DVD recorder can be played on almost any DVD player currently on the market. Our DVD drive offers consumers data storage in a PC and more comprehensive video editing as well as playback of recordings made with consumer electronics devices.

The year 2001 also saw the introduction of our first multi-channel Super Audio CD player, offering the best sound performance available today. By year-end 2001, some 600 SACD titles were available, of which a growing number of multi-channel releases.

For all these technologies we have an extensive licensing program, allowing us, together with our

### Now you're in control

At first glance the new Philips DVD-R1000 doesn't look much different from a regular DVD player. In fact, there is only one difference, but it's an important one – the red recording button. And that button is how Philips puts you in charge. Now you can enjoy digital-quality video from pre-recorded and home-recorded DVD discs.



partners, to set standards, create new markets and generate substantial revenue.

### Connectivity, convergence and the Internet

As devices become increasingly web-connected, we envision a future of always-on Internet accessibility, much like any other domestic utility. We have taken an important first step in this direction with the launch of our FW-i1000 Internet Audio system in the United States. Hooked up to a broadband Internet connection, it can access any of the thousands of radio stations currently online.

MP3-CD continues to grow in popularity, offering the best cost-per-megabyte value available today in removable digital storage. This year we have created an entire MP3-CD family, including the pocket-sized 8 cm eXpanium, and a whole range of portables, hi-fi mini systems and even CD recorders, all offering MP3-CD playback.

### E-marketing initiatives

In 2001 we collaborated with Philips Domestic Appliances and Personal Care in establishing an e-marketing platform. The roll-out, which will be done in the local language in those countries in which we do business, is expected to be completed during the first quarter of 2002. This common infrastructure will be leveraged to support our efforts in customer relationship marketing, improve overall consumer service and streamline transactional processing with our dealers.

The strategic marketing and technology partnership with America Online/Time Warner, the world's largest media conglomerate, which was announced in July 2001, has given a major boost to our online commercial activities. Drawing upon AOL's strengths in interactive marketing and its vast number of media worldwide, we are committed to leveraging Philips as a premium brand and to partnering in information devices, online services and entertainment. The first fruits of this



### New products

In the GSM area we introduced extensions to our Az@lis and Fisis product ranges in 2001. Excellent performance in China by our high-tier Xenium range is allowing us to benefit from the fast-growing market in the Asia Pacific region.

In the DECT business (cordless phones for the home) we have consolidated our No. 2 market position in Europe thanks to a well-balanced and differentiated product portfolio. In 2001 we introduced appealing new products, the Onis 200 and Kala 200.

relationship appeared in the final quarter of the year with the introduction of AOL Internet properties aimed at making online shopping easier and more enjoyable.

### Mobile phone business refocused

In 2001 we refocused Philips' mobile phone activities, with Philips Consumer Communications (PCC) ceasing to operate as an independent manufacturer of mobile handsets; this involved a major restructuring, particularly in France. Part of PCC's R&D capabilities and part of its manufacturing activities will be incorporated in partnerships with China Electronics Corporation (CEC). Philips has retained a minority shareholding in the manufacturing joint venture, which will serve a larger customer base on an ODM (original designer/manufacturer) basis and will allow Philips to continue to market and sell Philips-branded mobile phones in Europe and Asia Pacific, where the GSM standards prevail. The agreement with CEC leaves the creative power for our technology divisions (Components and Semiconductors) in mobile communications intact. On the other hand it enables the Consumer Electronics division to remain active in the mobile handsets market with





### **EISA success for 'the future of television'**

Philips has won an EISA Award for its new 32-inch plasma display set, its third consecutive Flat TV product to win such an award. Measuring just 9 cm deep, the super-slim set, which incorporates Philips' acclaimed picture enhancement technologies Digital Natural Motion, Digital Crystal Clear and Active Control, was described by EISA as 'the future of television'.

### **Compatibility without compromise**

The new Philips DVD recorder has been named *European Digital Video Recorder of the Year 2001-2002* by EISA. In its statement, the EISA jury said: 'The DVDR1000 takes off where the conventional video recorder stops, because of the limitations of tape. For the first time in Europe, it's now possible to record DVDs on a stand-alone device that can be played back on the majority of DVD players on sale'.

### **Super Audio CD**

In naming the new Philips Super Audio CD player *European Audio Player of the Year 2001-2002*, the EISA jury has underlined the fast-increasing recognition of the SACD format. The EISA award citation noted that the SACD1000 offers today's highest standards of audiophile sound reproduction quality in combination with multichannel SACD, universal CD and DVD-Video playback capabilities.



### **Rock it in your pocket**

The all-new, pocket-sized 8cm eXpanium eXp401 is Philips' exciting, new-generation MP3-CD player. We've used 'pocket science' to create a miniature player that's 40% smaller than a standard CD player – but still really big on music.

limited exposure. To this end, a new business unit, Wireless, will be set up within Consumer Electronics. As of January 1, 2002, Philips' DECT business has been fully integrated in the Wireless unit; the mobile handset activities will follow as of April 1, 2002.

### Gateway to the digital world

Digital Networks is at the forefront of digital convergence, transforming the way we access television and the Internet at home or on the move. Our set-top boxes and solutions for software, Internet streaming, rights management and broadcast transmission are helping to drive the migration from analog to the broadband digital world. Digital Networks' technology solutions enable service providers to deliver exciting and compelling content to consumers. For example, our state-of-the-art cable set-top box, launched during 2001 and powered by the Philips Semiconductors Nexperia™ processor, provides an advanced gateway for the secure delivery of broadcast, multimedia, Internet and telephony services to households.

### Converging focus

Philips' firm belief in open technology standards for healthy business development underpins Digital Networks' involvement in the Multimedia Home Platform (MHP). Supported by over 200 major broadcasters and technology companies, MHP provides a level playing field for the development of interactive and enhanced digital television. MHP addresses an over-diversity of proprietary technologies which have emerged during digital television's infancy, resulting in a slower market growth of services. In 2001, Digital Networks addressed this situation by strategically refocusing its set-top box activities, significantly strengthening relationships with key customers. At the same time, the group commenced a program of convergence towards two main set-top box platforms in order to reduce development costs while improving time-to-market and supply chain issues.

### MPEG-4

As the Internet transforms into a broadband, always-on medium, Digital Networks continued its strategic investment in MPEG-4, the standard for high-quality video, audio and multimedia streaming, during 2001. Digital Networks is focusing its application of MPEG-4 in the mobile wireless domain, forming a strategic alliance with Sun Microsystems to develop MPEG-4 distribution technology solutions.

### Content protection

In digital broadcast distribution, Digital Networks has advanced the protection of content via conditional access, watermarking and digital rights management solutions. Pioneering watermarking technology – a digital 'fingerprint' discreetly embedded in content for copyright verification – has even led to Philips' development of an equally innovative audio application for music copyright revenue management in radio broadcasting.

#### New name, new start

In 2001, PCB/Assembly – set up to bring together all the printed circuit board assembly operations of Consumer Electronics in one unit – was renamed Philips Contract Manufacturing Services (PCMS). At the same time it was announced that PCMS will be bringing its expertise to the external electronic manufacturing services market. With 7,000 employees and production centers in China, Europe, Mexico, Brazil, Singapore and India, PCMS now offers a full range of manufacturing services, including design, engineering, product introduction, prototyping, mass manufacturing and supply chain solutions.





## First to market!

Philips introduced Europe's first DVD recorder at the Internationale FunkAusstellung (IFA) in Berlin in August 2001. The original planned launch date was early 2002. We were determined to be first in the market with a DVD recorder and we succeeded. We had to bring the launch forward, which called for intense interdivisional cooperation.

It was agreed between the groups involved (from the Semiconductors, Components and Consumer Electronics divisions, spread over several countries) to start developments in parallel rather than sequentially. This approach is not without risk, but it minimizes the time required for the product creation process.

Expected output from one party, which would be the input for the other, was simulated by adding specific software to existing hardware. This enabled Consumer Electronics to develop the set in parallel with Optical Storage, which was developing the optical reading and writing unit, and Semiconductors, which was designing the specialized integrated circuits. As soon as changes in the original technology definitions appeared, they were communicated and implemented in the software.

# Better experien

*Philips Domestic Appliances and Personal Care develops, manufactures and markets a wide range of products in the fields of male shaving and grooming, body beauty and health, oral healthcare, home environment care, and food and beverage preparation. The division has a strong presence in all regions around the world and employs some 10,000 people.*

**Our strategic intent is to be an industry shaper in established global markets and a strong player with No. 1 and 2 positions in selected regional markets. For instance, we are the world market leader in the field of male shaving and No. 2 in the fields of irons and dental care. In the latter market, Sonicare, the electric toothbrush concept that we acquired through our takeover of Optiva Corporation, performed very well in 2001. In China, where we are the market leader in a number of important product categories such as shavers, depilators, blenders and irons, further double-digit growth was achieved in 2001.**

**In recent years we have strengthened our position as an innovative brand. This is based on ongoing and in-depth research into consumer needs, a strong technological foundation, high-quality design capabilities and effective business creation roadmaps. In addition, we have focused on fully integrated marketing strategies, with online and customer relationship marketing becoming increasingly important; the latter will be extended by our strategic cooperation with America Online (AOL).**



## **Tastes good**

With Senseo Crema you can now enjoy a perfect cup of coffee – topped by a rich layer of crema – whenever you feel like it. Each cup is freshly brewed, so you're always sure of that pure smooth taste. This revolutionary coffee maker was produced and marketed in a joint effort with Sara Lee | DE.



A close-up photograph of a woman with dark, wavy hair smiling warmly at a young child with light brown hair. The child is holding a white baby bottle to their mouth and drinking. The woman is also smiling, showing her teeth. The background is softly blurred, suggesting an indoor setting with natural light.

# ces

## Innovative partnerships with leading brands

The year 2001 saw the launch of another innovative product concept based on close cooperation with a world-renowned company in the fast-moving consumer goods industry: the Senseo Crema coffee maker, brought to market in conjunction with Sara Lee | Douwe Egberts. Its introduction was an unprecedented success. That was also true of the Coolskin II, the second generation of shavers featuring Nivea additives.

## Springboard to success

Our ongoing quality and efficiency improvement efforts are clearly bearing fruit, particularly in reducing lead time in the innovation and supply chain management process. Together with the initiatives outlined above, this will help us to realize our ambitions. We intend to create value and to contribute to the further enhancement of the Philips brand by offering consumers outstanding products that truly meet their needs and improve the quality of life in the home.

## Together in new electronic media

DAP is cooperating closely with Consumer Electronics in e-business, jointly developing a website (accessible via [www.philips.com](http://www.philips.com)) that offers consumers a full range of information and services tailored to each country. It also allows retail customers to place orders via secure extranet links. Now, DAP and CE are developing online properties in partnership with AOL / Time Warner. This will enable over 30 million AOL subscribers in the US and Europe to learn about Philips products while viewing content from Time Warner publications, helping them see how our products fit their lifestyles. This cooperation is accelerating both divisions' move into new marketing media.

# High-end digital

*Philips Components, headquartered in Sunnyvale, California, is a world-leading provider of integrated digital electronic solutions in the areas of displays, storage and connectivity. Its global customer base covers the computing, consumer electronics, telecommunications and automotive industries.*

*Philips Components currently employs more than 15,000 people in 39 countries around the world. It is a leading supplier of CRTs and LCDs through its joint ventures with LG Electronics of South Korea: LG.Philips Displays and LG.Philips LCD. It is also a leading provider of mobile telephone displays and speaker systems.*

**Philips Components will continue on its course to become a market leader in providing customized digital solutions to internal customers and leading OEMs. This is part of the division's transformation from a commodity component supplier to a supplier of digital subsystems and solutions based around the building blocks of displays, storage and connectivity, areas in which we have or are building a strong leadership position. We will shift allocation of capital and human resources toward system and architecture design and system-type selling. We aim to move up the value chain with a digital solutions focus, allowing us to capture a larger part of the value and leading to a significant increase in revenues through organic growth as well as alliances and acquisitions.**

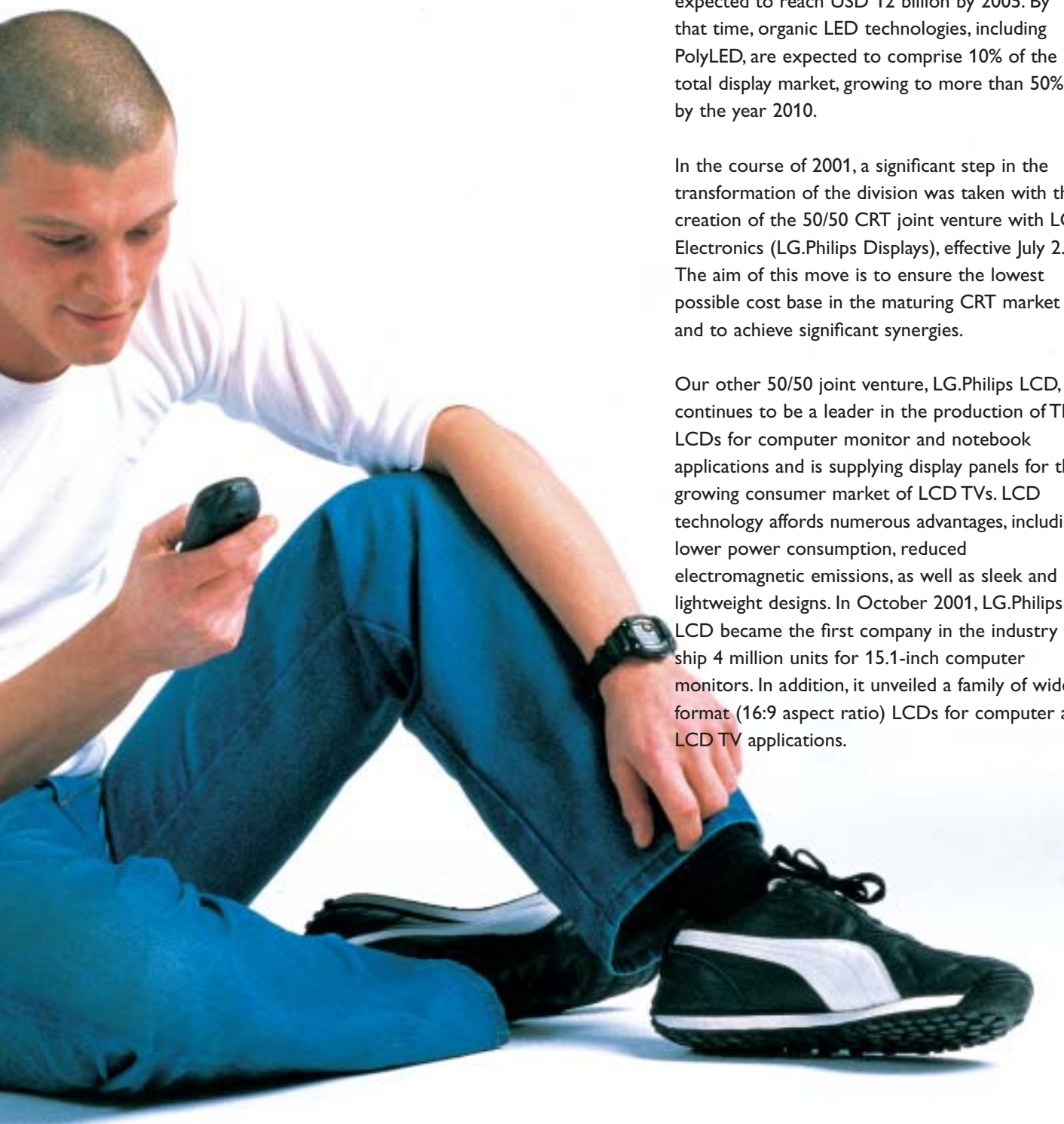


## **DVD+RW – the universal solution**

DVD+RW (offering recordable and rewritable functionality) allows the user to store enormous amounts of diverse data (movies, still digital photos, computer data, etc.) on a single disc and to play the disc on *any* DVD system.



# solutions



## Displays

An important development in 2001 was the establishment of Philips Mobile Display Systems (MDS) as a separate business group. MDS is one of the world's leading suppliers of mobile displays. In 1999, Philips successfully commercialized the first polymer organic light-emitting diode (PolyLED) technology, for use in end products for small-scale mobile applications, including cellular phones and pagers. According to DisplaySearch (Austin, Texas), the total market for display technologies is expected to reach USD 12 billion by 2005. By that time, organic LED technologies, including PolyLED, are expected to comprise 10% of the total display market, growing to more than 50% by the year 2010.

In the course of 2001, a significant step in the transformation of the division was taken with the creation of the 50/50 CRT joint venture with LG Electronics (LG.Philips Displays), effective July 2. The aim of this move is to ensure the lowest possible cost base in the maturing CRT market and to achieve significant synergies.

Our other 50/50 joint venture, LG.Philips LCD, continues to be a leader in the production of TFT LCDs for computer monitor and notebook applications and is supplying display panels for the growing consumer market of LCD TVs. LCD technology affords numerous advantages, including lower power consumption, reduced electromagnetic emissions, as well as sleek and lightweight designs. In October 2001, LG.Philips LCD became the first company in the industry to ship 4 million units for 15.1-inch computer monitors. In addition, it unveiled a family of wide-format (16:9 aspect ratio) LCDs for computer and LCD TV applications.

## Components

### Net display

Philips' net display modules are the 'engine' for flat display devices connected to the Internet, enabling a vast range of products, from web tablets to public information displays, kiosks and thin clients.



### Breakthrough in projection TV

Following intensive cooperation with Philips Research, a new display technology, Liquid-Crystal-on-Silicon (LCoS), has been introduced. This is a projection engine allowing OEMs to bring affordable, high-resolution, large-screen TVs to market more quickly. LCoS is a low-cost technology targeted for use in rear-projection applications such as home cinema systems.

### Storage

In optical storage, Philips Components is a leading innovator in CD and DVD formats for the information technology and consumer electronics markets. A broad alliance of more than 50 industry-leading PC, optical storage and consumer manufacturers now back the DVD+RW standard, and the number is growing all the time. Gartner Group/Dataquest analysts predict the rewritable DVD market will reach approximately 2.1 million units in 2002 and grow to 14.5 million units by 2005.

### Connectivity

Philips Components is building a position in wireless connectivity modules to address the digital, Internet-driven, 24/7 world, where consumers demand anywhere anytime interactivity. The division is developing networked products for at home and on the move through enabling technologies such as Bluetooth. Philips is committed to becoming the one-stop shopping hub for OEMs looking to bring both Bluetooth and 802.11A/B products to market. Key to this is the division's strong relationship with Philips Semiconductors.



### ProntoPro

Featuring a high-resolution 256-color touchscreen, 8 MB of flash memory, RF for multi-room control and a pick-up sensor that automatically activates the screen, the ProntoPro allows consumers to control and further customize their entire home theater experience with one remote that fits in the palm of the hand.



## Internet – anytime anywhere, thanks to Philips

Until now, OEMs building Internet appliances have had to turn to a variety of hardware and software vendors in order to produce a complete solution. This kept costs extremely high, prolonged time to market and resulted in products that were too thick and heavy to address today's extreme portability demands. However, all that has changed with the introduction of our net display, the world's thinnest, lightest Internet appliance for anytime anywhere Internet access.

Sixty per cent of the value of the product is made up of various technologies from within Philips, e.g. a 10.4-inch LG.Philips LCD screen, a Philips Semiconductors Trimedia chip for video streaming, RF 802.11B wireless connectivity from Philips Components, and an end-product design from Philips Design; furthermore, the Centre for Industrial Technology provided mechanical and testing support. The net display project was coordinated by Philips Components' Remote Control Systems business, which also added the overall system design and architecture as well as the software and applications.



# Bringing technol

*Philips Semiconductors is a major supplier of complex systems on silicon and standard semiconductor products for consumer electronics, telecommunications, automotive, computing and industrial applications. Our solutions are designed to grow and evolve as our customers – and their customers in turn – realize the full potential of fast-evolving digital technologies. The division has approximately 33,000 employees in more than 50 countries.*

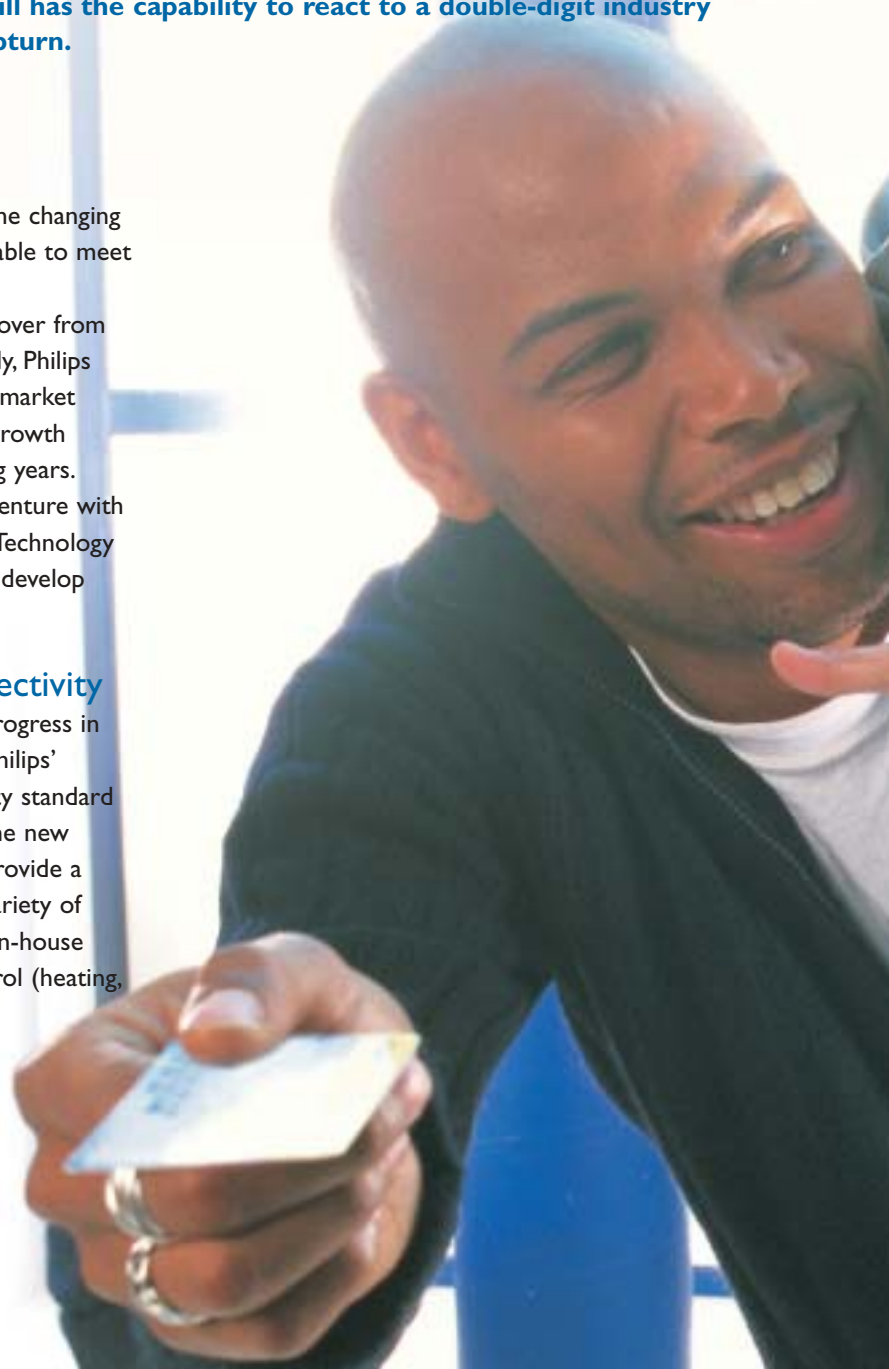
**In 2001, Philips Semiconductors maintained its strategic focus while responding to very tough market conditions. Against the background of an industry decline of around 30% compared with 2000, the division saw reduced revenues in most market segments, but with some notable areas of growth, such as automotive and security/identification. Philips Semiconductors reacted to the changing market conditions in the industry by, for example, lowering manufacturing capacity while ensuring that the division still has the capability to react to a double-digit industry upturn.**

## Fast response

In the communications segment, Philips Semiconductors responded quickly to the changing market dynamics and showed that it is able to meet the needs of the contract designers and manufacturers (ODMs) who are taking over from the branded handset makers. Additionally, Philips Semiconductors has a strong focus and market position in China, the largest potential growth market for mobile phones in the coming years. During the year, Philips formed a joint venture with China Academy of Telecommunications Technology (CATT) and CEC Wireless (CECW) to develop 3G phones for the Chinese market.

## Setting the standard in connectivity

The division has also made significant progress in its focus area of wireless connectivity. Philips' proposal for a new low-cost connectivity standard (ZigBee) was accepted by the IEEE as the new industry standard. This is expected to provide a whole new class of connectivity for a variety of applications including remote controls, in-house security systems and environment control (heating,



# ogy to life



## **Semiconductors for safety**

Security is a key issue in today's digital world, and Philips Semiconductors is focusing on the identification sector in particular. Notable achievements in 2001 include the successful deployment of a number of baggage tracking trials with major airlines, enabling them to achieve the high levels of security demanded in the travel industry.

light, ventilation) systems for the home. The division continues to ship chipsets for the volume connectivity standards – Bluetooth and 802.11 – making Philips the only company to support all major standards. By the end of 2001, the division had shipped over 7 million 802.11 A/B chipsets.

### The Nexperia revolution

In the consumer segment, the home is about to be revolutionized by a new generation of digital applications, wireless connectivity and new, simple user interfaces. Philips' Nexperia Digital Video Platform can help drive this revolution forward, and in 2001 the division gained the endorsement of major players for this architecture, which will be used in new generations of Digital TV coming onto the market in 2003/2004. This platform will enable a host of new digital services – games, interactive TV, video-on-demand and information services – to be delivered to home entertainment systems by cable, satellite or Internet providers. As we move to this exciting future, our flexible Nexperia design methodology is already enabling us to provide scalable, customizable solutions for the digital home; rapid, right-first-time solutions which are software-upgradeable to keep pace with emerging services.



A woman with dark hair tied back, wearing a white cable-knit sweater and a gold hoop earring, is shown in profile from the chest up. She is smiling and looking out over a body of water under a bright, hazy sky. Her hand is near her chin.

### Technology focus

Philips Semiconductors is a recognized leader in silicon manufacturing technologies for mobile telephony, including next-generation 3G mobile terminals and basestation infrastructures.

Successive generations of QUBiC, an advanced silicon-only RF process, have kept it up to date with the latest high-volume CMOS manufacturing processes, keeping production costs below those of competing technologies. Enhanced component integration repeatedly improves QUBiC's performance, while characterization and optimization of its CMOS transistors at RF frequencies opens up the possibility of low-cost RF CMOS solutions for cost-sensitive applications such as Bluetooth. Combined with the company's world-renowned expertise in RF circuit design, the QUBiC process makes Philips Semiconductors an industry leader in the supply of RF silicon solutions.

Bianca Thuyns and Zed Allahdini of Philips Semiconductors discussing floor plans to enhance the robustness of a chip.

### Wireless connectivity: a combined effort

Philips' vision of a world without wires will require the combined efforts of a number of divisions. Wireless connectivity has a wealth of potential applications: wireless headsets, integrated home environment management systems (heating, lighting, ventilation) and wireless offices, to name but a few. Philips Semiconductors has been at the center of Philips' efforts in this area, working together with Philips Research, which has been involved in the development of new technologies and standards, and Philips Components, which has created ready-to-use modules.

# Premier provider health

*Philips Medical Systems is one of the world's leading suppliers of medical imaging modalities and patient monitoring systems. It is a global leader in the product segments X-ray, ultrasound, nuclear medicine, patient monitoring, magnetic resonance, computed tomography and medical IT. Philips Medical Systems employs around 31,000 people.*

**Addressing a market that increasingly demands full-range suppliers able to provide total healthcare solutions, Philips Medical Systems is reaching for a global leadership position. Following a focused and ambitious program of acquisitions over the last three years, representing investments in excess of USD 5 billion, Philips Medical Systems is now able to offer integrated solutions covering the entire spectrum of diagnostic imaging and patient management needs.**

## Further strengthening market position

Through these strategic acquisitions, the division has added a strongly complementary range of capabilities covering all key segments of the diagnostic imaging and patient monitoring markets. Not only do the recent acquisitions offer opportunities to achieve far-reaching synergies enabling increased efficiency and cost savings right through the organization, they also enable Medical Systems to further strengthen its market position and gain additional sales opportunities by addressing the full range of medical systems requirements of today's healthcare providers. It will do this with state-of-the-art products and systems, but also with responsive, customer-focused services and support that range from initial consultancy and site planning right through to user training, in-depth application support and maintenance. This full-range capability gives Medical Systems a greatly enhanced proposition to its customers and makes it a strong and highly credible partner for healthcare institutions. This is especially relevant in the important US market, where the trend towards centralized, professional procurement models is rapidly taking hold.



# of care solutions

A photograph of a young woman with dark hair, smiling and looking towards the camera. She is wearing a black tank top with a white trim around the neckline. She is holding a white and black water bottle in her right hand. In the background, another person is visible but out of focus, wearing a red shirt.

## **Commitment to women's health**

Breakthrough imaging technologies are providing new information and insights into a wide range of specific women's health areas, such as breast and gynaecological cancers and obstetrics. All the key imaging technologies are applied in this area, including MRI, ultrasound, CT, nuclear medicine and PET, as well as cardiovascular X-ray, reflecting the fact that heart disease remains the No. 1 threat to women in many countries. The result of this effort is the ability to offer superior early diagnosis (thereby reducing the number of invasive surgical procedures needed), improved outcomes and a better quality of life for women around the world.



### World-class portfolio

Enriched by the recent acquisitions, Medical Systems possesses a world-class portfolio of technologies and competencies. Its excellent performance over recent years, with market-outperforming growth and consistent gains in market share, has provided a strong basis on which to invest in the future. The division has embarked on a Post Merger Integration project with the aim of creating a single, coherent organization right through the supply chain. This will enable customers to benefit from the increased breadth and depth of products and services, as well as from the synergies between the various companies, extending from technology and manufacturing right through to logistics and customer support.

### Integrating five best-in-class companies

The new Philips Medical Systems integrates five best-in-class companies, each with a reputation for excellence and a strong market position in its own right. In addition to the original Philips Medical Systems, these are: ADAC Laboratories, which possesses world-leading nuclear medicine and radiation therapy planning technologies and competencies; Agilent Healthcare Solutions Group,



with an outstanding range of cardiology ultrasound, electrocardiography and external defibrillator systems; ATL Ultrasound, a worldwide leader in diagnostic medical ultrasound systems; and Marconi Medical Systems, a company with 85 years of experience in medical diagnostic imaging, specializing in CT scanners, MR imaging systems and nuclear medicine systems.

### Other acquisitions

The year 2001 also saw the acquisition of Medcare, which allows Philips, in the USA, to expand its multivendor maintenance, asset management and biomedical engineering programs and thus strengthen its partnership with hospitals.

### Into a new realm

The exciting developments outlined above have strengthened the fundamentals of Philips Medical Systems, enabling the division to enter a new realm as a premier provider of healthcare systems.



### Powerful imaging capability

The Philips SONOS 5500 has all the advanced features clinicians want in a high-performance digital ultrasound system. Exceptional image quality, best-in-class contrast imaging tools, unique quantitative techniques, extensive applications and an intuitive user interface allow the most comprehensive echo examinations possible.





### Bringing heart care to the home

At the beginning of 2001, Philips Medical Systems took an 80% stake in a joint venture with SHL Telemedicine Ltd. Through this joint venture, which operates under the name Philips HeartCare Telemedicine Services, we have entered a promising new market for remote cardiac monitoring of patients in their own homes. The service is based on the model that SHL has successfully developed in Israel, where it has over 60,000 subscribers whose cardiac function is monitored by telephone links to a medical call center. There, trained medical personnel, in close cooperation with doctors and specialists, provide analysis and consulting, instructing patients on the action to take. This enables patients to assume greater responsibility for their own health. In the USA, Philips is marketing a package for people with chronic heart disease to help them better manage their condition.

### Medical Systems and Research: synergies in technology

One of the strongest synergy areas between Medical Systems and other parts of the Philips organization can be found in the field of research. The technology capabilities of Philips Research are at the heart of a constant stream of innovative new medical product concepts. Among the most recent are the BV Pulsera system that meets the X-ray imaging needs of the most demanding surgical procedures and interventions; the new first-of-a-kind SonoCT ultrasound system with XRES technology for improved image processing, originally developed for MR; and the new XMR combined MRI and X-ray cath lab imaging system, which promises clinicians unrivalled power to make faster and more accurate diagnoses.

# Innovation powe

*As one of the largest private-sector research establishments in the world, Philips Research supports all Philips' lines of business and is a key driver of the Company's high-growth technology strategy. Philips Research not only generates innovations in each of the Company's main strategic pillars in the high-volume electronics domain – displays, storage, connectivity and digital video-processing – but is also uniquely positioned to identify and explore the synergies between these pillars.*

**With laboratories in Europe, Asia Pacific and North America, Philips Research has a global presence, allowing fast and efficient deployment of new technologies into optimal local solutions and standards. An example is the development by Philips Research East Asia of wireless communication technologies, digital television, optical storage systems and speech-recognition modules for the Chinese market.**



## **On display**

At the Internationale Funkausstellung (IFA) in Berlin and several other major exhibitions, Philips Research demonstrated a prototype of a reflective Liquid-Crystal-on-Silicon (LCoS) rear-projection display of breathtaking brightness, contrast and resolution. The display combines several innovative technologies, which were developed in joint projects of Philips Research with Philips Consumer Electronics, Philips Components, Philips Semiconductors and Philips Lighting. Another highlight presented at the IFA was the world's first matrix display that keeps on functioning while being bent, an important step towards fully flexible mobile displays.



## Future standards

Optical recording is characterized by long-lived standards. Philips, together with Sony, was there in the beginning when the CD (684 Mbyte storage capacity) was conceived, and was also involved in the development of the next step, the DVD (4.7 Gbyte). Although DVD will be the standard for some time to come, discussions about and research into the next generation of optical recording systems are already in full swing. Philips and Sony have jointly proposed the technology platform for third-generation optical recording. Using a blue laser and a double lens system, a storage capacity as high as 22.5 Gbyte can be achieved.

## Ambient Intelligence

With Moore's law still showing that the number of transistors that can be put on a chip doubles every eighteen months, the computing power in our homes will continue to increase exponentially. But the way we experience this computing power is about to change. The proliferation of buttons and menu options will be ended and replaced with intelligent systems that respond to, and even anticipate, our needs. Philips calls this vision Ambient Intelligence.

Philips is ideally placed to provide many of the technology solutions to realize this vision. For example, it is a strong player in the RF communications technology for wireless in-home digital networks. For the display-centric environment of Ambient Intelligence, Philips has solutions ranging from LCD modules for hand-held devices to large-area flat-panel displays that can be built into the walls of a room.

In the drive for new technological solutions, it is, however, essential to remain focused on the needs of their eventual users. By creating multi-disciplinary research groups, including designers, ergonomists and trend analysts from Philips Design, a new methodology evolves – one where user needs are at the heart of the research process.

To investigate the practical, psychological and social implications of Ambient Intelligence, Philips Research is soon to open its HomeLab project in Eindhoven. Comprising a fully equipped home, complete with living, sleeping and kitchen facilities, HomeLab will provide an infrastructure in which Ambient Intelligence can be developed.

### Maximizing value of intellectual assets

As of January 1, 2002, Corporate Intellectual Property and Standards & Licensing joined forces in a new organization called Intellectual Property and Standards (IP&S). This merger will improve efficiency, cooperation and the effective use of resources. The mission of IP&S is to create a strong IPR portfolio for Philips and to generate maximum returns from its intellectual property.

Despite the general slowdown in the economy, IP&S was able to maintain the level of direct licensing income from third parties in 2001. Major successes were achieved with licensing programs in the fields of optical storage, digital video and IC buses. Moreover, a number of promising new licensing programs for future revenues have been started in various areas, such as image coding. Via cross-licenses, IP&S was able to give Philips' business units a considerable competitive edge in terms of non-cash benefits by providing access to third parties' inventions. Value was also created by contributing intellectual property rights as assets in return for a share in a number of participations.

### Protection of innovations

Enforcing trademarks and design rights, IP&S also successfully conducted raids and seizures against companies making or trading illegal copies of Philips products and preventing those companies from cashing in on Philips' innovations. Furthermore, IP&S has vigorously pursued cybersquatters who appropriated domain names that included the Philips name.

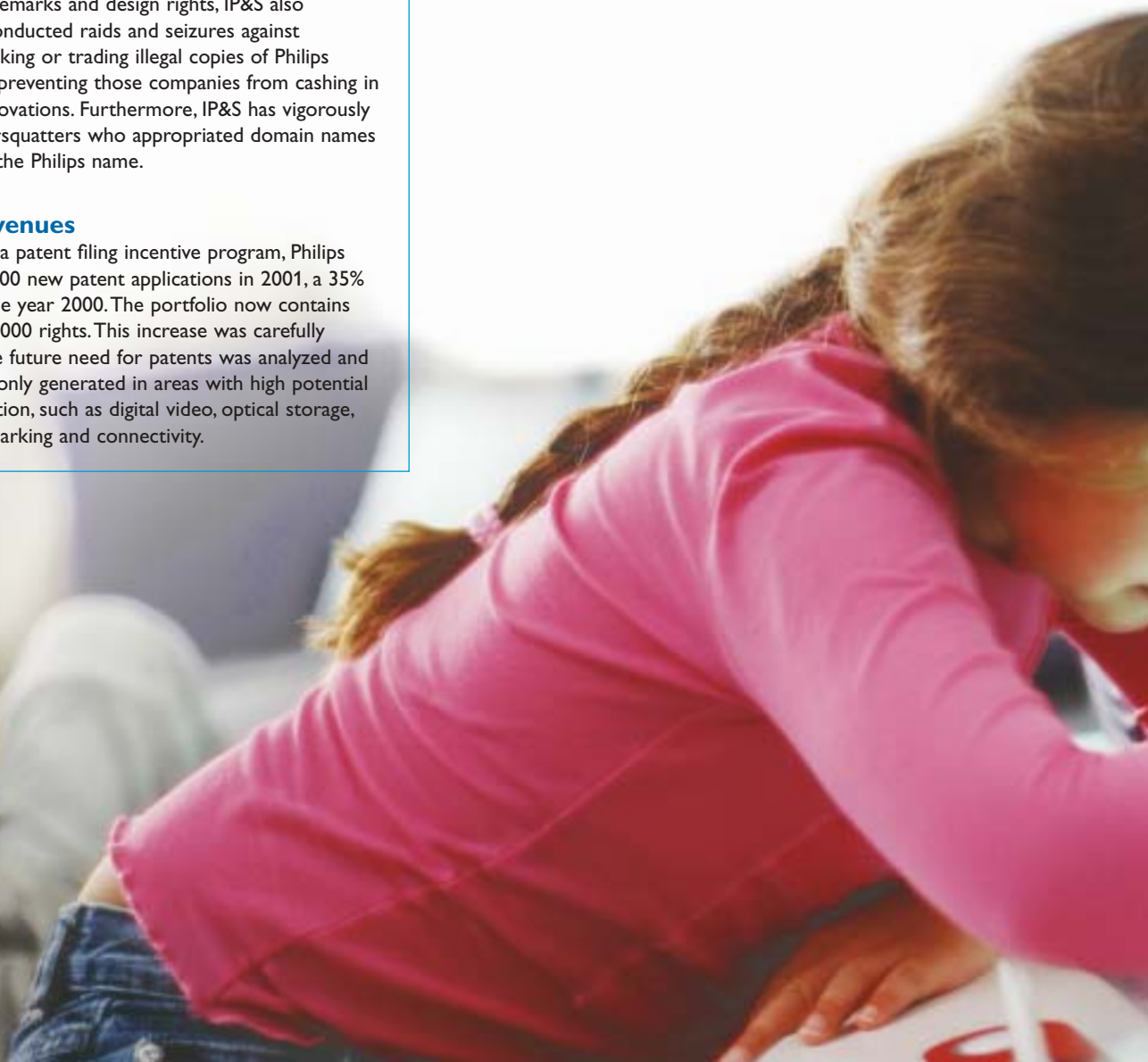
### Future revenues

Stimulated by a patent filing incentive program, Philips filed some 3,000 new patent applications in 2001, a 35% increase on the year 2000. The portfolio now contains more than 75,000 rights. This increase was carefully controlled: the future need for patents was analyzed and patents were only generated in areas with high potential for value creation, such as digital video, optical storage, digital watermarking and connectivity.

### Innovation in manufacturing

Philips' Centre for Industrial Technology (CFT) is a renowned center of competence supporting the product divisions and a number of external high-tech companies in all aspects of production, particularly in the areas of mechatronics, electronics, process technology, assembly and industrial support.

CFT can look back on a number of successful cooperations with the product divisions and Philips Research in 2001, cooperations that strongly support the Company's high-growth technology ambition. For example, it helped Philips Lighting analyze its production processes for UHP lamps and formulate an industrial strategy for the years 2001-2005. In addition, it contributed to the design, realization and ramp-up of a sealing-in process and machine.







### **Excellence by design**

Philips Design works according to its proprietary High Design process, a human-focused, multi-disciplinary, research-based approach intended to provide clients with competitive and sustainable solutions. Each year, 5% of Philips Design's turnover is re-invested in enriching knowledge through its R&D program. The 2001 program was dedicated to the design and branding of Philips Ambient Intelligence, exploring the application of interconnected, anticipatory and responsive technologies distributed throughout e.g. the home, the workplace, the public space, etc. The quality of Philips Design's concepts and research approach is confirmed by the many prestigious design awards won each year, e.g. the Industrial Design Excellence Award from the Industrial Designers Society of America and the iF Product Design & Interface Award from the International Forum Design Hannover.

### **Productive cooperation**

Philips Research was closely involved in the development of Panorama 1T, the world's first high-field, actively shielded, lightweight open magnetic resonance system, launched this year by Philips Medical Systems. The open MR system provides superior patient comfort and acceptance, as well as unrivalled patient access. Research contributions were in magnet, gradient and RF-subsystem design and modeling, system software and image processing.

Cooperation between Philips Semiconductors and Philips Research has resulted in the successful integration of an acoustic echo-cancellation algorithm into current-generation GSM mobile handsets. The echo-cancellation algorithm suppresses the return echo that results from shrinking mobile handset sizes.

### **Playing the digital way**

Pogo, an interactive system that helps develop children's creativity through shared storytelling – developed by Philips Design with partners as part of a European Commission multi-disciplinary research project.

# Report on the performance of the Philips Group

1. The following discussion is based on the consolidated financial statements and should be read in conjunction with the other financial information.
2. The consolidated financial statements were prepared on a basis consistent with generally accepted accounting principles in the Netherlands (Dutch GAAP).
3. This section of the Annual Report represents a summary of the Operating and Financial Review and Prospects as included in the separate booklet entitled 'Financial Statements and Analysis'.
4. Special items, as presented in the Operating and Financial Review and Prospects, relate to income and expenses resulting from normal business operations, which, because of their size or nature, are disclosed separately to give a better understanding of the underlying result for the period. These include items such as restructuring and impairment charges, acquisition-related charges and significant gains and losses on the disposal of businesses or participations. In some analyses these special items have been excluded from income in order to give a better insight into the comparable performance of the Philips Group. However, the reader should note that income from continuing operations excluding special items is not a measure of financial performance as defined by Dutch or US GAAP.



### The year 2001

- **Sales fell 15%, in line with slowdown of world's economies and downturn in mobile phone and IT-related industries**
- **Net income: a loss of EUR 2,604 million; special items: a loss of EUR 1,696 million, including a non-cash charge for impairment of non-current financial assets**
- **Positive cash flow from operating activities: EUR 1,248 million; net debt to group equity ratio of 27:73**
- **Unconsolidated companies: a loss of EUR 754 million, mainly due to losses in the LG.Philips LCD and LG.Philips Displays joint ventures and lower income at TSMC**
- **Changes in business portfolio: reduced capital exposure to mobile phone, VCR and CRT markets and increased presence in medical systems markets**
- **Further rationalization of manufacturing and cost base**

### Downturn in markets in 2001

		1999	2000	2001*
PCs	million units	114	131	121
	% growth	24	15	(8)
Cellular phones	million units	280	416	390
	% growth	74	49	(6)
Mainstream CE	value in billions of euros	80	96	89
	% growth	8	20	(7)
Semiconductors	value in billions of euros	140	222	157
	% growth	24	58	(30)

\* provisional data

### Net income excluding special items

in millions of euros	2000	2001
As published	9,602	(2,604)
per common share in euros - basic	7.31	(2.04)
Special items:		
Affecting income from operations	1,070	(1,235)
Affecting financial income and expenses	2,322	(526)
Affecting results relating to unconsolidated companies	3,397	(248)
Income taxes related to special items	(18)	313
Excluding special items	2,831	(908)
per common share in euros - basic	2.16	(0.71)

### Summary

After the record year 2000, the Company's performance in 2001 was severely impacted by the worldwide economic downturn in the telecom and IT-related markets, resulting in a negative net income of EUR 2,604 million (net income excluding special items amounted to a loss of EUR 908 million).

Our electronics businesses Semiconductors, Consumer Electronics and Components, as well as some of our major unconsolidated companies such as Taiwan Semiconductor Manufacturing Company (TSMC), LG.Philips LCD and LG.Philips Displays, were severely impacted by the decline.

Our Lighting, Domestic Appliances and Personal Care and Medical Systems businesses, which operate in less cyclical markets, continued their solid performances. Domestic Appliances and Personal Care and Medical Systems (the latter before acquisition-related charges) recorded their best year ever.

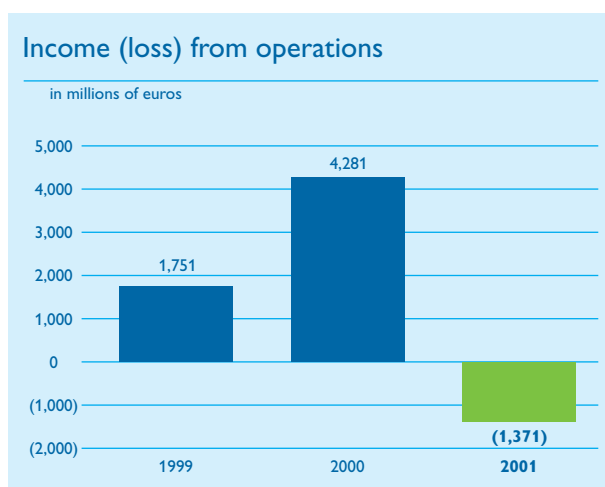
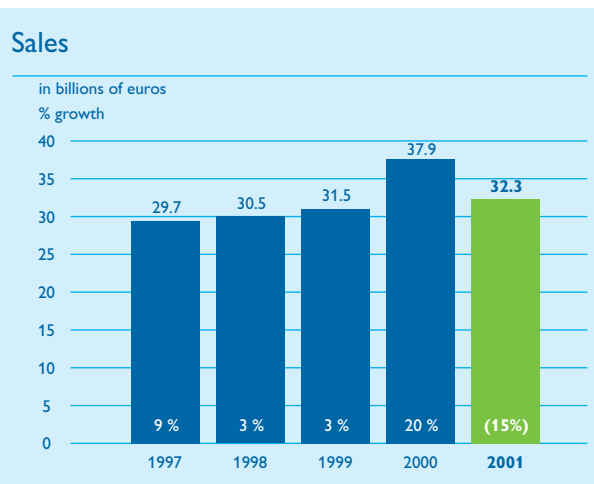
Philips managed the downturn by further lowering its cost base and reducing capacity, and by outsourcing or shifting production to partners. Several uneconomical semiconductor and component production lines were closed, a joint venture was entered into with LG Electronics in the field of display components, and the decision was taken to outsource the manufacturing and some of the development of mobile telephones and video recorders. Digital Networks refocused its strategy and limited its platform diversity.

Income included special items, mainly relating to:

- restructuring and asset impairment (EUR 1,093 million);
- acquisition-related charges (EUR 437 million);
- gains on sales of participations (EUR 295 million);
- impairment of security investments (EUR 526 million).

Reduction of the Company's overcapacity was the main reason for the restructuring, while recent acquisitions caused in-process R&D write-offs and integration costs at Medical Systems.

The extended period of time over which the market



value of security investments in Vivendi Universal and GN Great Nordic was below book value, resulted in impairment of these shares.

The market value of our investments in other publicly quoted companies exceeded their book value by EUR 8,838 million.

Despite the losses, Philips was able to generate EUR 1,248 million positive cash flow from operating activities in 2001. Gross capital expenditures for property, plant and equipment were scaled back by one third compared with 2000 to EUR 2,143 million.

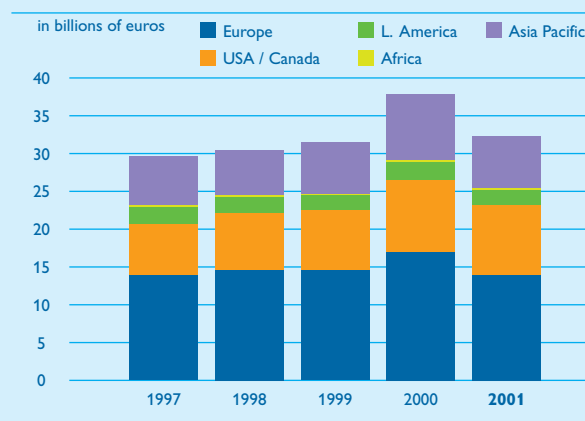
#### Group sales and income from operations

Sales totaled EUR 32,339 million, 15% lower than in 2000. Changes in consolidations had a 1% negative effect. Sales volume decreased by 6%, while average prices declined 8%. Sales at Semiconductors, Components, Mainstream Consumer Electronics and Consumer Communications were affected by the downturn in the respective markets. Sales at Lighting remained virtually flat, while sales at DAP and Medical Systems increased strongly, both organically and as a result of acquisitions. At Digital Networks, the sales decline reflected the strategy to reduce platform diversity and the customer base, while sales at Consumer Communications were impacted by the decision to lower the exposure to the mobile phone manufacturing activities. Display Components was deconsolidated; a joint venture was established with LG Electronics for the manufacturing and sale of commodity picture tubes.

Income from operations in 2001 amounted to a loss of EUR 1,371 million, or 4.2% of sales, compared to income of EUR 4,281 million, or 11.3% of sales, in 2000. Excluding special items, income from operations amounted to a loss of EUR 136 million, reflecting the weakness in many of our markets, which resulted in significantly higher price erosion and lower volume. In particular, excess inventory in the supply chain on the electronic markets resulted in a decline in market prices which could not be offset by efficiency improvements. Reduction of the Company's overcapacity resulted in restructuring and impairment charges, net of releases, of EUR 1,093 million, while other acquisition-related charges totaled EUR 437



### Sales per geographic area



### Income (loss) from operations per geographic area

in millions of euros	1999	2000	2001
Europe	1,124	3,246	(479)
USA / Canada	82	186	(854)
Latin America	(41)	59	(13)
Asia Pacific	585	787	(15)
Africa	1	3	(10)

### Most important unconsolidated companies

	since	Philips' share in common stock
TSMC	1986	21.8%
LG.Philips LCD	1999	50.0%
SSMC	1999	48.0%
Atos Origin	2000	48.7%
LG.Philips Displays	2001	50.0%
FEI	1997	25.5%
LumiLeds Lighting	1999	50.0%

million, of which EUR 379 million at Medical Systems. Income from operations included amortization of goodwill and other intangibles for an amount of EUR 477 million, compared to EUR 342 million in 2000. Negative pension costs amounted to EUR 430 million, compared with EUR 445 million in 2000. Negative pension costs will be significantly lower in 2002 as a consequence of stock market performance.

### Sales and income from operations by geographic area

All regions recorded lower sales in 2001. The decline in sales was sharpest in Asia Pacific, partly due to the deconsolidation of Display Components. Other significant decreases in Asia Pacific related to Mainstream CE, Digital Networks, Licenses, Components and Semiconductors. The sharp decline of sales in Europe was caused by deconsolidation effects (Origin and Display Components), the refocusing of the mobile phone activities at Consumer Communications and the downturn at Components and Semiconductors. The sales decrease in Latin America was attributable to deconsolidations and weaker currencies, in addition to lower sales at DAP, Digital Networks, Components and Semiconductors. Sales in USA/Canada ended slightly down, impacted by lower sales at Semiconductors, Mainstream CE and Components, partly offset by higher sales from acquisitions at Medical Systems.

Income from operations in 2001 deteriorated in all regions. Europe, Asia Pacific and USA/Canada showed the sharpest decreases in income, driven by the unfavorable developments at Semiconductors, Components and Consumer Electronics. In 2000, income in Europe and Asia Pacific was positively affected by the non-cash gain on the sale of Origin and the gain on the sale of the AC&M business.

### Results relating to unconsolidated companies

Results relating to unconsolidated companies in 2001 came to a loss of EUR 754 million, compared to a profit of EUR 3,970 million in 2000. The operational performance of Taiwan Semiconductor Manufacturing Company (TSMC), LG.Philips LCD and the newly established joint venture LG.Philips Displays suffered from the severely depressed mobile phone and IT-

## Results relating to unconsolidated companies

in millions of euros	1999	2000	2001
Operational income (loss)	391	697	(139)
Special items	67	3,397	(248)
Amortization of goodwill and other intangibles	(49)	(124)	(367)
Total	409	3,970	(754)

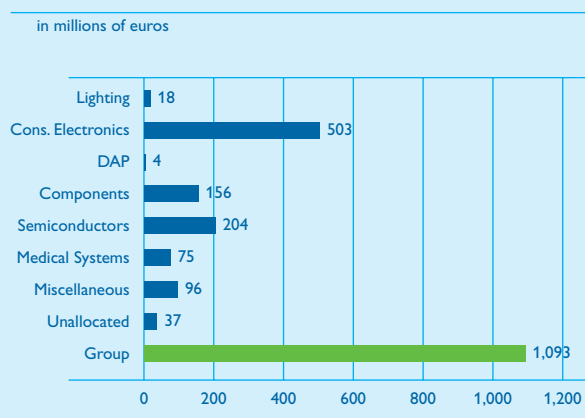
related markets. The results relating to unconsolidated companies included amortization costs for goodwill and other intangibles amounting to EUR 367 million (in 2000: EUR 124 million) and special items related to restructuring and changes in equity ownership, amounting to a loss of EUR 248 million (in 2000: a profit of EUR 3,397 million). Excluding amortization costs and special items, our share in the results of these companies deteriorated by EUR 836 million.

## Restructuring and impairment

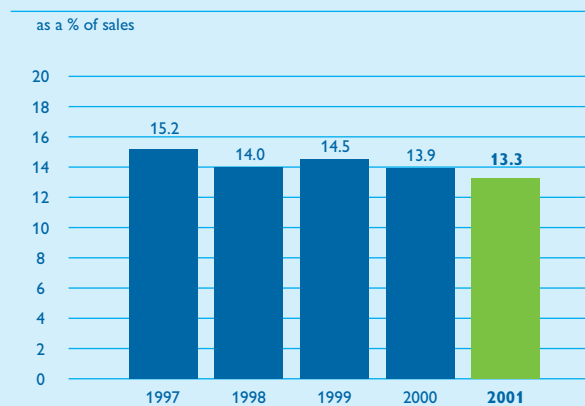
In 2001, Philips reduced overcapacity, improved efficiency and addressed loss-making activities. This led to restructuring and impairment charges in income from operations amounting to EUR 1,093 million for various projects, net of releases. The most significant restructuring charges in 2001 related to:

- the outsourcing of development and manufacturing of mobile phones (EUR 318 million);
- the closure of production lines at Semiconductors, Albuquerque, USA and the announced closure at Caen, France (EUR 204 million);
- rationalization of manufacturing capacity at Optical Storage and process rationalization at Mobile Display Systems, Components (EUR 167 million);
- programs to reduce platform diversity at Digital Networks (EUR 122 million);
- integration and process standardization of the European commercial sector of Medical Systems after the acquisition of the medical systems divisions of Agilent and Marconi (EUR 74 million);
- downsizing of Philips Enabling Technologies Group in the Netherlands and Belgium and the worldwide Assembléon activities (EUR 67 million);
- outsourcing of development and manufacturing of video recorders (EUR 44 million).

## Restructuring and impairment by sector



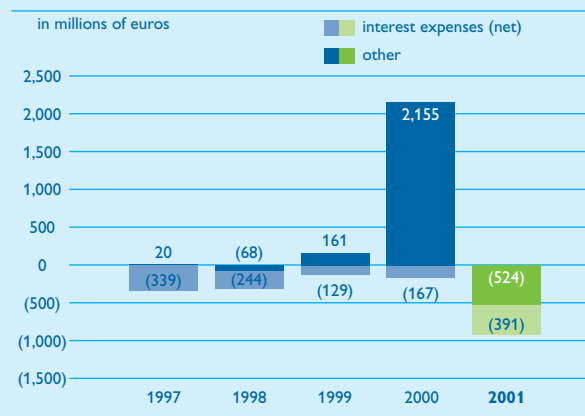
## Inventories



Approximately half of the restructuring charges included in income from operations comprised non-cash charges in 2001.

In addition, our share in restructuring charges recognized by our unconsolidated companies amounted to EUR 89 million and as such is included in results relating to unconsolidated companies.

## Financial income and expenses

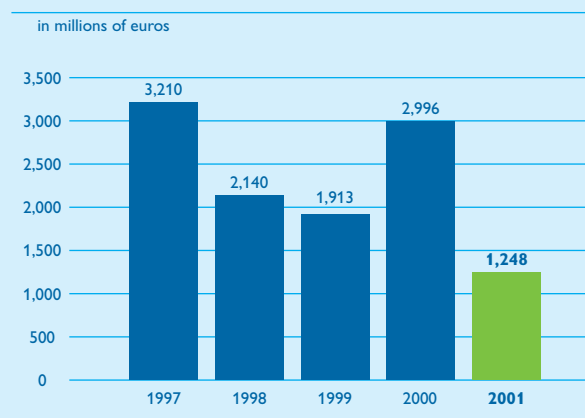


## Financial income and expenses

Financial income and expenses amounted to expense of EUR 915 million in 2001, compared to income of EUR 1,988 million in 2000. Net interest expenses amounted to EUR 391 million in 2001, compared with EUR 167 million in 2000. The net interest expenses were higher, primarily due to the increase in net debt, partly offset by lower interest rates.

Due to lower share prices of some security investments (Vivendi Universal and Great Nordic), an impairment loss of EUR 526 million was taken in 2001. During the year 2000, the Company sold a portion of the JDS Uniphase shares that had previously been received upon the sale of Philips Optoelectronics. Net gains from the sale amounted to EUR 1,207 million. Moreover, in 2000 Seagram shares were exchanged for shares in Vivendi Universal, resulting in income of EUR 966 million.

## Cash flows from operating activities



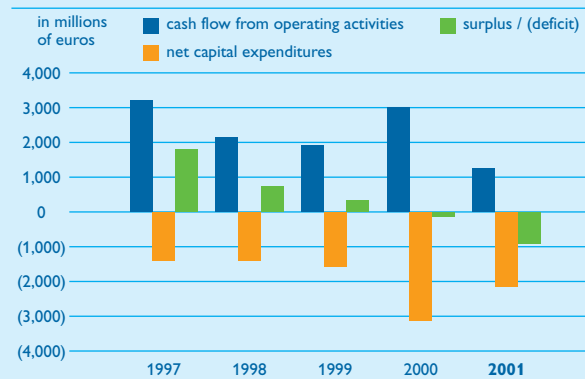
## Income taxes

Income taxes represented a benefit of EUR 421 million in 2001, compared to a charge of EUR 570 million in 2000. This corresponds to an effective tax rate of 18% in 2001, up from 9% in 2000.

## Minority interests

In 2001, the share of third-party minority interests in the loss of group companies amounted to EUR 15 million, compared with a share in income of EUR 67 million in 2000. The change in income is mainly attributable to the consolidation of NavTech as of January 1, 2001 and the deconsolidation of FEI. Moreover, minority interests decreased as a consequence of the buy-out of minority shareholdings in India, Pakistan and South Africa.

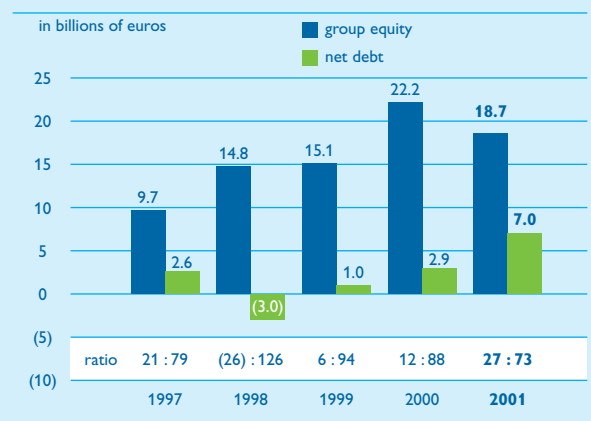
## Cash flows from operating activities less net capital expenditures



## Cash flows

Philips was able to generate a positive operating cash flow in 2001 in spite of the severe market conditions. Our cash conversion cycle program led to significant reductions of inventories and receivables, partly offset by lower payables. Inventories at the end of 2001 came to 13.3% of sales, compared to 13.9% a year earlier. Cash flows from operating activities amounted to EUR 1,248 million in 2001, compared to EUR 2,996 million in 2000.

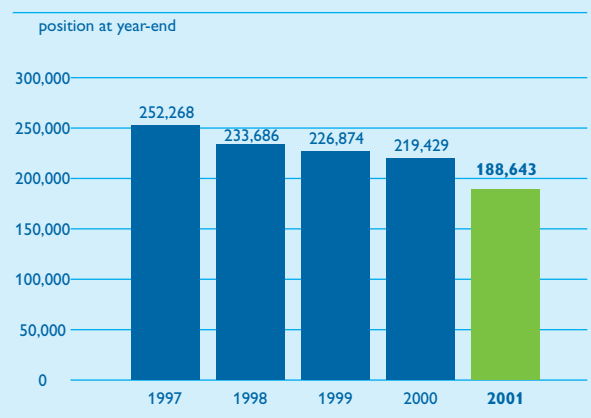
## Net debt to group equity



Cash used for investing activities totaled EUR 4,564 million, of which EUR 3,636 million was for the purchase of businesses, particularly at Medical Systems, compared to EUR 2,404 million in 2000. Proceeds from the sale of businesses totaled EUR 755 million in 2001. Of these, the most important were the Glass activities of Components (as part of the newly established joint venture with LG Electronics) together with part of the shareholding in FEI and Philips Broadcast. Gross capital expenditures were scaled back by approximately one third, as compared to 2000, to EUR 2,143 million as we aligned our components and semiconductors manufacturing facilities to the lower level of market demand.

The Company issued two tranches of new eurobonds in May 2001 and two tranches in July 2001, totaling EUR 4,250 million. This increased the net debt to EUR 6,976 million at year-end. Cash provided by financing activities in 2001 totaled EUR 3,159 million compared with cash requirements of EUR 2,038 million in 2000. The latter included a capital repayment to shareholders of EUR 1,673 million from the share reduction program.

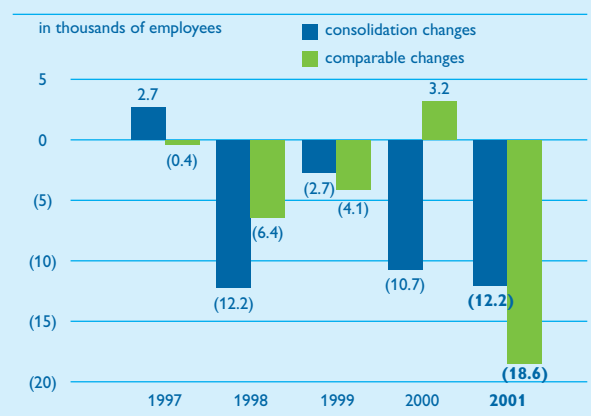
## Employees



## Employment

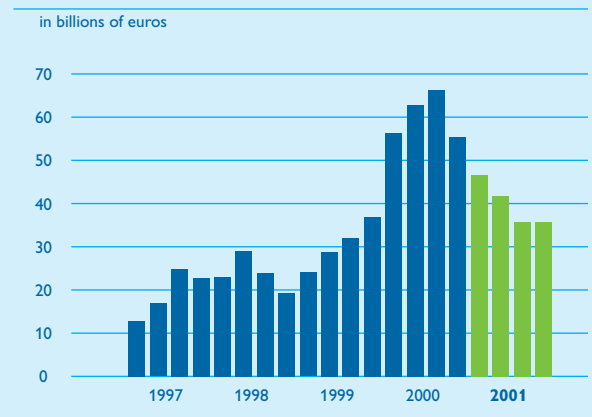
The number of employees at December 31, 2001 totaled 188,643, a decline of 30,786 from December 31, 2000. A large part of the decrease is related to the deconsolidation of various businesses, involving a reduction of 27,684 in total, of which Display Components was the most significant (23,251). Conversely, 15,470 employees were added to the Company's payroll as a result of new acquisitions. The most significant were Agilent Healthcare Services Group (4,770) and Marconi Medical Systems (5,200). Excluding changes related to the portfolio, the number of employees decreased by 18,567. The main reductions in the headcount were at Components (5,207), Semiconductors (4,053), Mainstream Consumer Electronics (2,389) and Consumer Communications (2,165). In geographic terms, Asia Pacific and Europe accounted for most of the decrease.

## Composition of changes in employees





### Average market value per quarter



### US GAAP

The Group financial statements have been prepared under Dutch GAAP, which differs in certain respects from US GAAP. Income from continuing operations determined in accordance with US GAAP was a loss of EUR 2,475 million in 2001, compared with a profit of EUR 9,577 million in 2000. These aggregate amounts result in basic earnings per common share of a loss of EUR 1.94 in 2001 and a profit of EUR 7.30 in 2000. Diluted earnings per common share amounted to a loss of EUR 1.94 in 2001 and a profit of EUR 7.22 in 2000. Please refer to note 27 to the consolidated financial statements for a description of the primary differences between Dutch GAAP and US GAAP and the earnings per common share information.

### Distribution to shareholders

With the approval of the Supervisory Board and the Meeting of Priority Shareholders, a proposal will be submitted to the General Meeting of Shareholders to make a distribution to shareholders of EUR 0.36 per common share charged to the other reserves (compared with EUR 0.36 dividend per common share paid in 2001, reflecting the 2000 profit distribution).

The balance sheet presented in this report, as part of the consolidated financial statements for the period ended December 31, 2001, is before distribution, which is subject to shareholder approval after year-end. Adoption of the proposal by the General Meeting of Shareholders will result in a total cash payment in the year 2002 and a reduction of other reserves by EUR 459 million (compared with EUR 458 million in 2001).

## Lighting

- Sales growth driven by innovation
- Reinforcement of global market leadership
- Continued strong earnings and cash contribution
- Ongoing high sales growth in China

The lighting market declined somewhat in 2001, affected by the economic slowdown, particularly in USA/Canada, and the energy crisis in Brazil.

Sales at Lighting totaled EUR 5,083 million, a 1% increase, which was mainly innovation-driven. Adjusted for the divestment of the batteries business, sales growth was 2%. Sales growth was particularly strong in Automotive & Special Lighting.

Geographically, sales growth was strongest in Asia Pacific. All businesses contributed to a slight improvement in overall market share, reinforcing global market leadership.

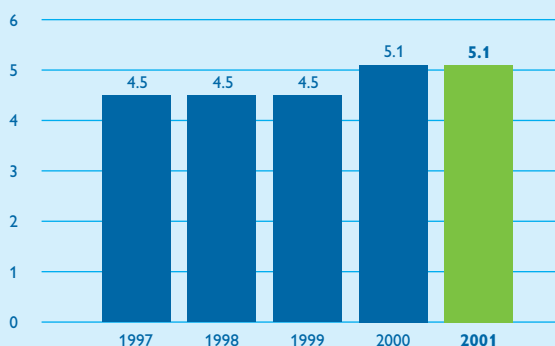
Income from operations totaled EUR 623 million, or 12.3% of sales. This income includes a gain on the sale and lease-back of two office buildings (EUR 44 million) and certain restructuring charges (EUR 18 million). After several years of improved operations and higher margins, income from operations was impacted by a mix shift, as growth in high-end margin products slowed down somewhat in 2001. In addition, the stronger Polish currency put pressure on margins, as Poland is an important supply base. In the light of these developments, focused cost management remains key for the profitability of the division.

### Unconsolidated companies

In the LumiLeds Lighting 50/50 joint venture, Philips and Agilent continue to strengthen the product portfolio, allowing for fast growth and extension of LED applications.

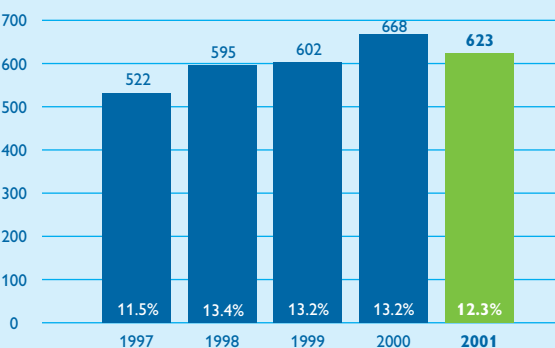
### Lighting - sales

in billions of euros



### Lighting - income from operations

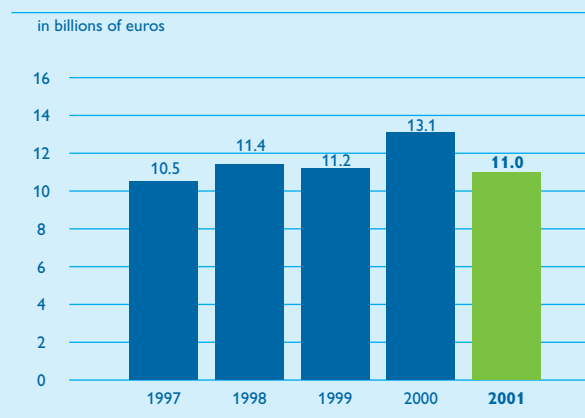
in millions of euros  
as a % of sales



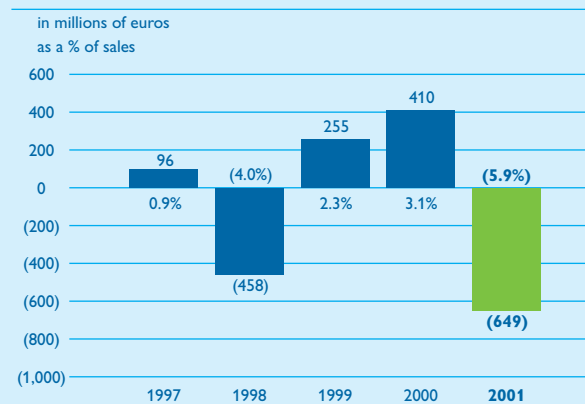
## Consumer Electronics

- **Worldwide operations excluding USA are profitable; USA situation being addressed**
- **Efficiencies in VCR improved by production outsourcing; continued cash generation**
- **Development and manufacturing of mobile phones outsourced**
- **Sales in high-growth DVD market almost doubled**
- **Monitor market heavily impacted by fall of PC sales**
- **Reduced cost base at Digital Networks by limiting platform diversity**

### Consumer Electronics - sales



### Consumer Electronics - income from operations



Sales at Consumer Electronics totaled EUR 11,052 million in 2001, a decrease of 15% compared with the previous year. Sales volume fell by 3%, while average prices decreased by 12%. Price erosion increased, due to weaker demand in most regions and intensified competition. The market decreased by 8% as a result of the global economic slowdown. In particular, the US market was hit hard, but a slowdown in growth was also seen in Asia Pacific and Latin America.

Sales of Mainstream CE declined by 6%. Price erosion for the year was at a level of 10%, while sales volume increased by 4%. Monitors were severely affected by the downturn in the world PC market, which significantly impacted OEM sales. VCR sales decreased, principally due to the worldwide migration towards DVD. While DVD sales nearly doubled, they did not fully offset the decline in VCR sales. Audio sales decreased 7% due to weak demand in North and Latin America, while sales in Europe and Asia Pacific remained stable. TV sales were marginally lower, reflecting lower sales in North America, Latin America and Asia Pacific, partially offset by an increase in Europe.

Sales at Digital Networks in 2001 were down 37% compared to 2000. The refocus on key customers accounted for most of this decrease. The market growth rate for set-top boxes declined sharply to 9% in 2001, following the steep rise of 73% in 2000. The lower sales of satellite and cable network set-top boxes in Europe and of Internet TV in the USA were only partly offset by doubled sales of satellite/terrestrial set-top boxes in the USA. The worldwide slowdown in the telecom markets contributed to a significant reduction in Broadband Networks sales.

The sharp fall in Consumer Communications sales reflects the repositioning of the GSM mobile phones, which particularly affected sales in Europe. GSM sales continued to show positive growth in Asia Pacific, especially in China.

Income from operations at Consumer Electronics in 2001 decreased to a loss of EUR 649 million (excluding special items: a loss of EUR 146 million) from a profit of EUR 410 million (excluding special items: a profit of EUR 427 million) in 2000. The 2001 result includes

### Consumer Electronics per business

amounts in millions of euros			
	2001		
	sales	income (loss) from operations	as a % of sales
Mainstream CE	8,665	(250)	(2.9)
Digital Networks	743	(329)	(44.3)
Consumer Communications	1,253	(421)	(33.6)
Licenses	391	351	89.8
Consumer Electronics	11,052	(649)	(5.9)

restructuring and impairment charges of EUR 503 million.

The income from operations of Mainstream CE amounted to a loss of EUR 250 million (excluding special items: a loss of EUR 186 million) following the trend of the worldwide CE industry. The division reported significantly reduced margins in most of its markets, particularly USA/Canada. Restructuring charges of EUR 64 million were recorded during the year. The charges are related to the Company's decision to outsource production and development of video recorders and to transfer monitor production from Taiwan to mainland China.

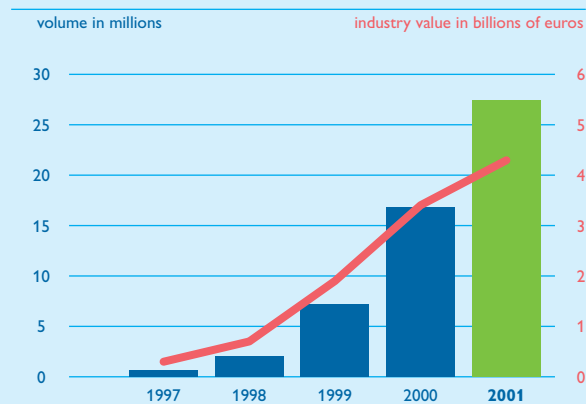
### Consumer Electronics per business

amounts in millions of euros			
	2000		
	sales	income (loss) from operations	as a % of sales
Mainstream CE	9,265	183	2.0
Digital Networks	1,178	(85)	(7.2)
Consumer Communications	2,207	1	-
Licenses	410	311	75.9
Consumer Electronics	13,060	410	3.1

The loss at Consumer Communications of EUR 421 million (excluding special items: a loss of EUR 104 million) originated mainly from the change in strategy for the mobile telephone business. The Company outsourced the manufacturing and part of the development activities of the GSM mobile phone business to China Electronics Corporation (CEC). The 2001 result also included an insurance benefit of EUR 41 million.

At Digital Networks the sharp downturn in sales led to a substantially higher loss totaling EUR 329 million (excluding special items: a loss of EUR 207 million). Special items included substantial inventory impairments in the Internet and Personal TV business in North America. To address the lower market demand and the pressure on margins, Broadband Networks and Digital Transmission Systems were restructured. In addition, the cost of development of new technologies in MP4Net, Softworks and CryptoTec increased R&D spending. Digital Networks will focus on a limited number of customers and will reduce its number of platforms to two. This should result in a decrease of the cost base.

### DVD world market, in volume and value



License income in 2001 increased to EUR 351 million, primarily due to the recognition of EUR 82 million of CD-R/RW royalties attributable to prior years. During 2001 the basic CD patents expired, except in the USA. Execution of new programs such as CD-R/RW and DVD became more important during 2001.



## Domestic Appliances and Personal Care

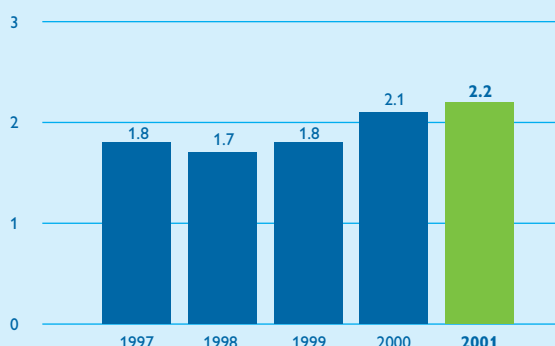
- **Record income from operations**
- **Continued market leadership and high profitability in shavers**
- **Sonicare (acquired from former Optiva) moved to No. 1 market position in the USA**
- **Successful introduction of Senseo Crema coffee maker**

Sales in 2001 totaled EUR 2,224 million, an increase of 6% over the previous year. Changes in consolidation, notably the consolidation of Optiva, lifted sales by 6%. Volume growth was 1%, while average prices declined by 1%. The sales growth is mainly attributable to Oral Healthcare. Sales of male shavers increased steeply in China (16% up), reaching 3.5 million units and reinforcing market leadership in that growth market. This, along with a good performance in Europe, compensated for the lower sales in the USA. The successful launch of the Senseo Crema coffee maker contributed positively to the sales performance.

Geographically, sales increased strongly in China and Europe. In North America, Philips Oral Healthcare's sales grew sharply, which was partly offset by a decline in the other businesses due to sluggish economic conditions. Adverse economic conditions also impacted sales in Latin America.

### DAP - sales

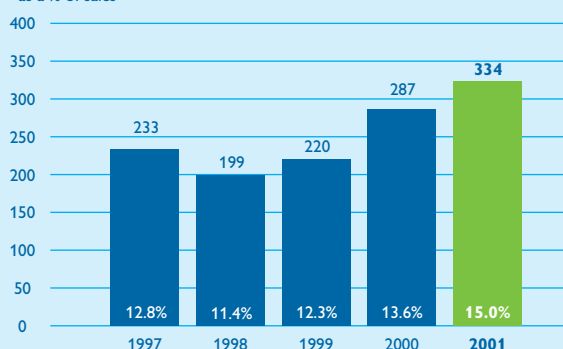
in billions of euros



Income from operations increased by 16% to EUR 334 million, continuing the growth pattern of recent years and defying the adverse market conditions. The successful integration of Optiva, which yielded positive income in the first year after acquisition, contributed to increased profitability. The launch of Senseo Crema, together with ongoing portfolio rationalization and tight cost control, also contributed to the improvement.

### DAP - income from operations

in millions of euros  
as a % of sales



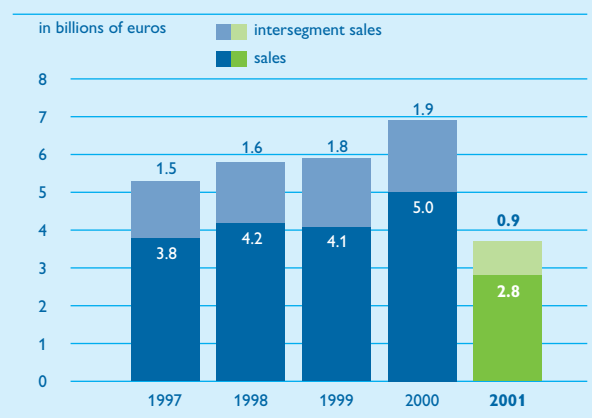
## Components

- **Comparable sales down by 29% due to severe price erosion and weak mobile phone and IT-related markets**
- **Joint venture established with LG Electronics for television and monitor tubes**
- **Restructuring charges taken to reduce capacity and create cost efficiencies**

The financial data relating to Display Components have been consolidated in the Group figures for the first six months of 2001 only, due to the transfer of Display Components to the joint venture with LG Electronics of Korea from July onwards.

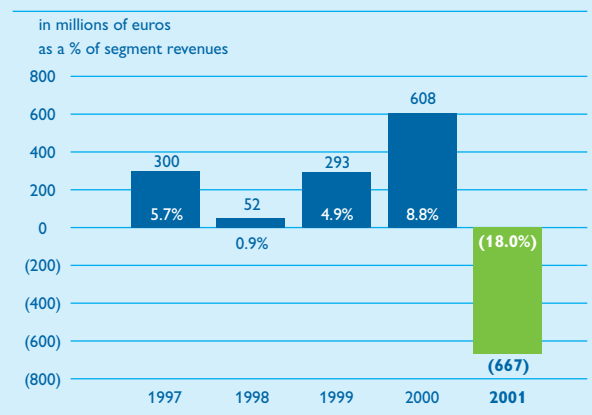
Sales in the Components sector came to EUR 2,772 million in 2001, a decrease of 45% compared with 2000. A substantial part of the decrease (16%) was caused by deconsolidations, of which Display Components was the most significant. In addition, sales were negatively impacted by a volume reduction of 19% and price erosion of 10% as a result of the slowdown of key markets to which the division is supplying, such as the PC and cellular phone markets.

### Components - sales



The mobile displays market decreased by 2% in value during 2001, while sales fell by around 30%. Mobile Display Systems suffered from a strong excess inventory situation in its markets, which only started to clear up during the third quarter. Market acceptance of color screens is slow, except in Japan, where Mobile Display Systems does not yet have a market position. The optical storage market witnessed a severe decline. Philips' performance in this business was slightly below the market, mainly due to time-to-market issues. Segment revenues (which include intersegment sales) decreased by 46%.

### Components - income from operations



Income from operations decreased to a loss of EUR 667 million in 2001, compared to a profit of EUR 608 million in 2000. Income in 2001 includes special items of EUR 157 million (predominantly restructuring). The restructuring charges relate to realignment of cost levels to the present market situation and the transfer of activities to low-cost areas. Excluding these special items, income from operations amounted to a loss of EUR 510 million, mainly due to the decline in top-line sales as a result of the depressed markets, which severely impacted the performance of Optical Storage and Mobile Display Systems.

Income from operations in 2000 included a special gain of EUR 309 million from the divestment of the AC&M business.

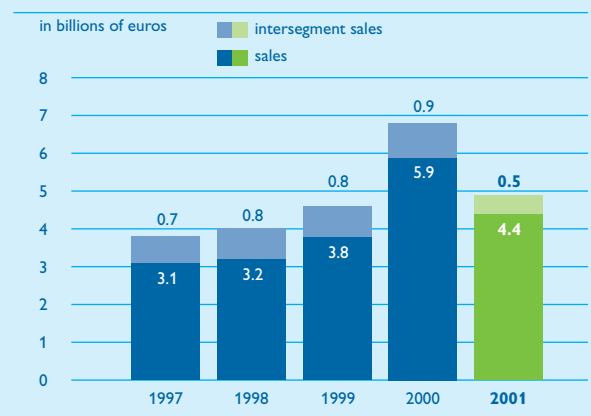
## Semiconductors

- **Most severe downturn in semiconductor history resulting in worldwide overcapacity**
- **Focus to reduce capital employed by reduction of capacity and cooperation with partners**
- **Strong position in cash-generating analog consumer ICs maintained**
- **From No. 4 to No. 2 in strategically important identification market**
- **Firmly established as the global No. 1 supplier of Bluetooth and 802.11 chipsets**

**Sales** in the Semiconductors sector in 2001 totaled EUR 4,389 million. This represents a decline of 25% compared to the year 2000, despite the 3% positive effect of the acquisition of MiCRUS as of June 1, 2000. The effect of exchange rate differences was negligible. Sales volume decreased 18%, while average prices fell 10%. The strong decline was caused by the most severe downturn in semiconductor history (30%, according to preliminary WSTS statistics), resulting from the slowdown of the world's economies and the PC and telecom markets, and occurred across all business lines and geographic areas. Segment revenues decreased by 27% in 2001 compared to the previous year.

Lower than expected presence in high-growth markets put pressure on market shares. The division maintained its strong position in the low-growth but profitable analog markets, while focus on high-growth markets continues.

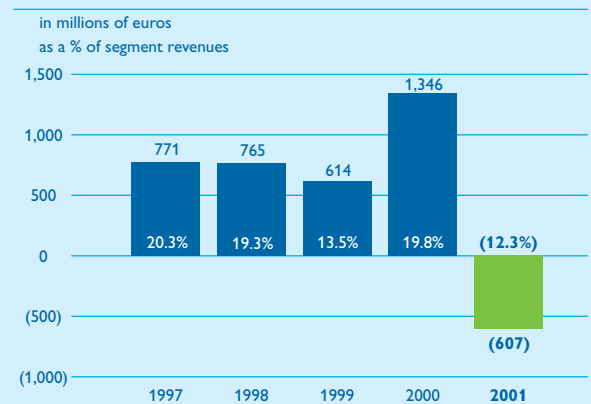
### Semiconductors - sales



**Income from operations** in 2001 was a loss of EUR 607 million compared to a profit of EUR 1,346 million in the previous year. Income in 2001 decreased considerably compared with last year, mainly as a result of slower end-user demand, which led to increased price erosion. The severe market conditions, coupled with a worldwide increase in production capacity, led to sharply reduced factory utilization well below break-even level. Moreover, actions taken to control inventory levels had a negative effect on 2001 income.

Existing capacity was reduced by closing one wafer fab in Albuquerque, USA, with the announced closure of another in Caen, France. The cost of these measures was EUR 204 million. To further limit our costs, cooperation with TSMC, SSMC and STM will be continued. A joint pilot production facility is being built together with STM. Income in 2001 included EUR 39 million for the settlement of insurance claims for the fire in Albuquerque.

### Semiconductors - income from operations



## Medical Systems

- **Record income from operations (excluding special items and amortization charges)**
- **No. 2 position in medical equipment**
- **Order intake (excluding acquisitions) up 11% compared with market increase of 7%**
- **Integration of medical businesses expected to yield significant savings**

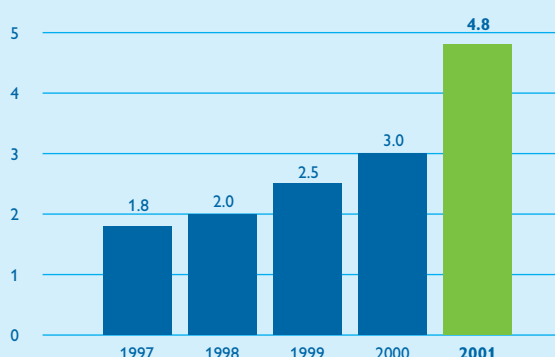
During the year Philips acquired the medical systems divisions of Agilent and Marconi, substantially improving its position in the medical markets, particularly patient monitoring and medical diagnostic imaging.

Sales in the Medical Systems sector in 2001 totaled EUR 4,834 million, representing 59% growth. Excluding the effects of the acquisitions, sales increased by 10%. This comprised volume growth of 12%, partially offset by price erosion of 3%, and positive currency effects of 1%.

All regions posted positive sales growth, most significantly North America and Europe. In product terms, the main growth areas are magnetic resonance, computed tomography, X-ray and the customer support business. Order intake excluding acquisitions increased by 11% in 2001, ahead of the market average of 7%.

### Medical Systems - sales

in billions of euros

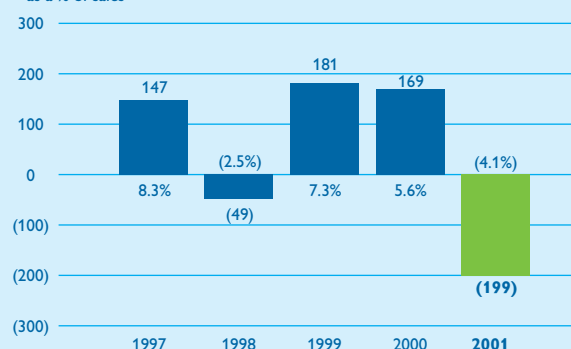


Income from operations in 2001 included acquisition-related costs including in-process R&D write-offs of EUR 379 million and restructuring charges of EUR 75 million. After the recent acquisitions, income for 2001 included amortization costs for goodwill and other intangibles for an amount of EUR 231 million compared to EUR 95 million in 2000. Excluding special items and amortization charges, income from operations improved by EUR 178 million to a record EUR 486 million. This improvement mainly came from the increase in sales and the success of the product range of our Magnetic Resonance and X-ray businesses. MedQuist also contributed to the improvement.

The integration of the new acquisitions and the related restructuring program are on schedule; integration is expected to yield significant savings of EUR 350 million by the end of 2003.

### Medical Systems - income from operations

in millions of euros  
as a % of sales





## Miscellaneous

- **Continued portfolio rationalization**
- **Philips ETG and Assembléon impacted by weak semiconductor equipment market**
- **Sold part of shareholding in FEI (gain of EUR 185 million) and Philips Broadcast (gain of EUR 57 million)**
- **NavTech consolidated**

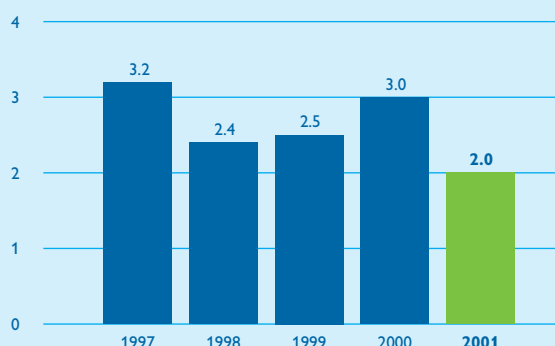
This sector mainly consists of two groups of activities: the central research and technology centers (such as Philips Research, Intellectual Property & Standards, Philips' Centre for Industrial Technology and Philips Design) and Corporate Investments (such as NavTech, Assembléon and Philips Enabling Technologies Group (PETG)). NavTech was consolidated in 2001 following the conversion of debt into equity, raising our stake from 50% to 82%.

Sales in the Miscellaneous sector in 2001 came to EUR 1,985 million, a 33% decrease on 2000, mainly due to the deconsolidation of FEI, Broadcast and Marantz.

Income from operations in 2001 amounted to a loss of EUR 104 million (excluding special items: a loss of EUR 246 million), or 5.2% of sales, compared to a loss of EUR 191 million (excluding special items: a loss of EUR 56 million), or 6.4% of sales in 2000.

### Miscellaneous - sales

in billions of euros

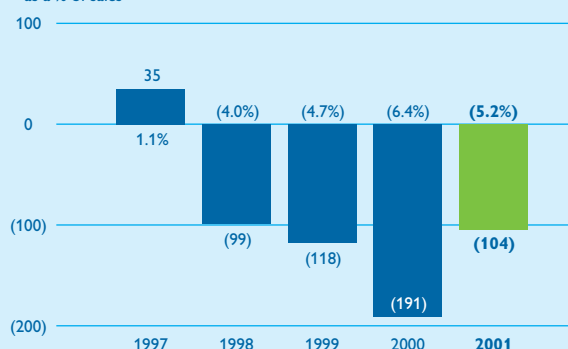


Income in 2001 benefited from gains on the sale of part of the investment in FEI (EUR 185 million) and the divestment of Philips Broadcast to Thomson Multimedia (EUR 57 million), partly offset by restructuring charges, mainly for PETG and Assembléon, and acquisition-related costs. Income in 2000 included special charges, totaling EUR 135 million, for the disentanglement of Philips Projects, sold to Tyco, impairment charges for Voice Control Systems and restructuring charges.

Excluding special items, income decreased significantly, due to operational losses at PETG and Assembléon, which suffered from the downturn in the semiconductor equipment market. These operational losses were partly offset by the improved performance of Philips Speech Processing. Moreover, income in 2001 was affected by the deconsolidation of the profitable FEI business and the consolidation of the loss-making NavTech activities.

### Miscellaneous - income from operations

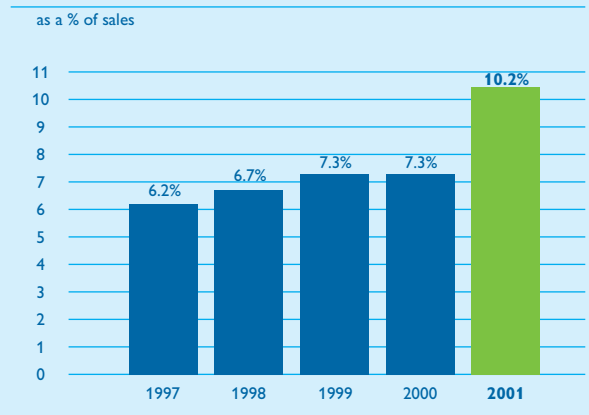
in millions of euros  
as a % of sales



A number of businesses in the Corporate Investments group are in the low-growth low-return area and are being considered for divestment.

In 2001, expenditures for R&D activities included in income of the product divisions, mainly Semiconductors, amounted to EUR 3,312 million,

## Research and development expenditures



representing 10.2% of sales, compared to EUR 2,766 million, or 7.3% of sales, in 2000. Approximately half of the major increase in 2001 related to new acquisitions.

### Unallocated

This product sector comprises the costs of the corporate center – including the Company's initial funding of e-business and global brand management programs – as well as country and regional overhead costs. Income from operations amounted to a loss of EUR 102 million in 2001 compared to a loss of EUR 79 million in 2000.

A decline in group overheads in 2001 was offset by lower pension credits.

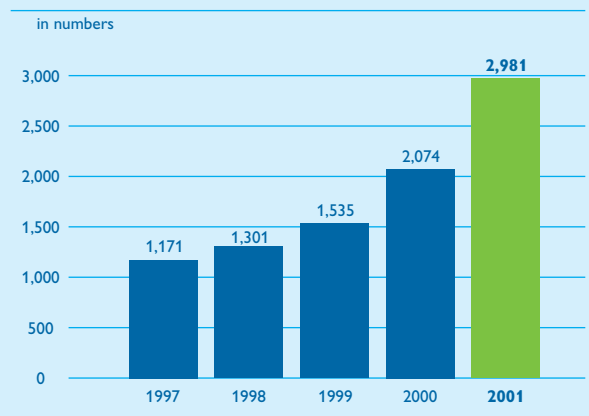
### Proxy solicitation

Philips is continuously striving to improve relations with its shareholders. For instance, Philips was one of the key companies in the establishment of the Shareholders' Communication Channel – a pilot project of Euronext Amsterdam, banks in the Netherlands and several major Dutch companies to simplify contacts between a participating company and its shareholders.

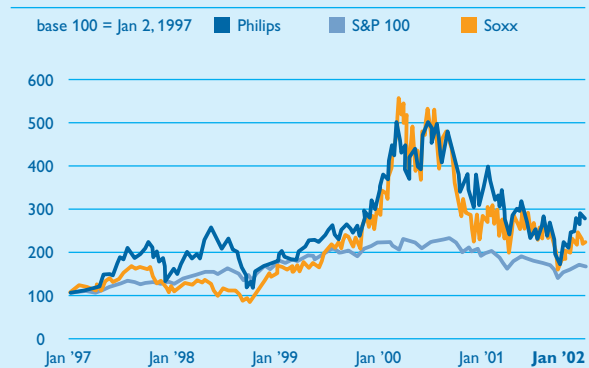
Philips will use the Shareholders' Communication Channel to distribute the Management Report booklet of its Annual Report and the Agenda for this year's General Meeting of Shareholders. As in 2001, Philips will use a proxy solicitation system in the Netherlands for this year's General Meeting of Shareholders; a voting instruction form will be distributed via the Shareholders' Communication Channel. For the General Meeting of Shareholders on March 28, 2002 a record date (being March 21, 2002) will apply: those persons who on March 21, 2002 hold shares in the Company and are registered as such in one of the registers designated by the Board of Management for the General Meeting of Shareholders will be entitled to participate and vote at the meeting.

Philips is convinced of the value of the Shareholders' Communication Channel and will continue to advocate its widespread adoption. In a broader context, Philips is constantly striving to improve its contacts with the financial community at large.

## Patent filings



## 5-year relative performance: Philips, S&P 100, Soxx



## Business Principles

The Philips General Business Principles govern the Company's business decisions and actions throughout the world, applying equally to corporate actions as well as the behavior of individual employees when on company business. They incorporate the values on which all Philips activity is or should be based: integrity, fair trade, non-discrimination and equal opportunities. These Principles have been translated into the local language in almost all countries. The responsibility for compliance with the Principles rests first and foremost with the management of the business. In every product division and country organization a Compliance Officer has been appointed. The Philips Intranet provides information on how to contact the Compliance Officer.

The Review Committee General Business Principles supervises the practical implementation. With a view to ensuring maximum transparency for shareholders and other interested parties, it was decided in 2001 to devote a special section of our Internet site ([www.investor.philips.com](http://www.investor.philips.com)) to specific issues: environment, health and safety, child and forced labor, political payments, military and defense contracts, and OECD Guidelines.

Our program – building upon long-standing practice in the US – to introduce guaranteed-anonymity hotlines for reporting of suspected contraventions of the General Business Principles has met with a very favorable response.

In the light of the increasing emphasis on corporate social responsibility and the Company's stated objective of integrating financial and non-financial external reporting by the year 2004, we are in the process of completing the establishment of an audit and reporting structure that covers health and safety issues in addition to the environmental reporting already in place. With regard to child labor, we have determined, on the basis of an extensive inventory of group companies and subsidiaries, that Philips does not employ child labor; steps are now being taken to extend this analysis to sub-contractors and major suppliers in high-risk regions.

## Outlook

Economic conditions around the world continue to point to a limited growth environment. Improvement in results in 2002 will come mainly from cost reductions, efficiency improvements and restructuring programs, many of which were already initiated in 2001, as well as ongoing portfolio management. As a consequence of weakness in the stock markets, we anticipate a significant reduction of pension credits in our results throughout 2002.

The severe declines of the IT and telecommunication markets, which were so damaging in 2001, have now stopped, and excess inventories, both at customers and in the industry, have mostly disappeared. In general, we do not see markets strengthening, therefore we maintain a cautious stand on costs, capital spending, working capital and employment in 2002.

The Company has been streamlined and focused during the downturn and is in a good position to be an early beneficiary of any upturn in its markets.

February 5, 2002

*Board of Management*

## Board of Management



**Gerard Kleisterlee** 1946, Dutch

**President/CEO and Chairman of the Board of Management and the Group Management Committee**

*President/CEO and Chairman of the Board of Management of the Company since April 2001; member of the Board of Management since April 2000; member of the Group Management Committee since January 1999*



**Jan Hommen** 1943, Dutch

**Executive Vice-President and Chief Financial Officer**

*Member of the Board of Management and the Group Management Committee and Chief Financial Officer since March 1997*



**Arthur van der Poel** 1948, Dutch

**Executive Vice-President**

*Member of the Board of Management since May 1998; member of the Group Management Committee since May 1996*



**John Whybrow** 1947, British

**Executive Vice-President**

*Member of the Board of Management since May 1998; member of the Group Management Committee since April 1995*



## Group Management Committee

The Group Management Committee is composed of the Board of Management and the following senior officers:



**Ad Veenhof** 1945, Dutch

**Senior Vice-President**

*Member of the Group Management Committee since January 1996 and President/CEO of the Domestic Appliances and Personal Care division since 1996*



**Hans Barella** 1943, Dutch

**Senior Vice-President**

*Member of the Group Management Committee since March 1997 and President/CEO of the Medical Systems division since 1997*



**Guy Demuynck** 1951, Belgian

**Senior Vice-President**

*Member of the Group Management Committee since April 2000 and President/CEO of Mainstream Consumer Electronics since 2000*



**Jan Oosterveld** 1944, Dutch

**Senior Vice-President**

*Member of the Group Management Committee since May 1998; responsible for Corporate Strategy since 1997 and for Regions and Countries since 2000*



**Tjerk Hooghiemstra** 1956, Dutch

**Senior Vice-President**

*Member of the Group Management Committee since April 2000; responsible for Human Resources Management since 2000*



**Ad Huijser** 1946, Dutch

**Senior Vice-President and Chief Technology Officer**

*Chief Technology Officer since May 2001; member of the Group Management Committee since April 1999 and CEO of Philips Research since 1998*



**Arie Westerlaken** 1946, Dutch

**Senior Vice-President**

*Member of the Group Management Committee since May 1998, Secretary to the Board of Management since 1997 and Chief Legal Officer since 1996*



**Matt Medeiros** 1956, American

**Senior Vice-President**

*Member of the Group Management Committee since November 2000 and President/CEO of the Components division since 2000*



**David Hamill** 1957, British

**Senior Vice-President**

*Member of the Group Management Committee since May 2001 and President/CEO of the Lighting division since 2001*



**Scott McGregor** 1956, American

**Senior Vice-President**

*Member of the Group Management Committee since January 2002 and President/CEO of the Semiconductors division since 2001*

## Supervisory Board



**L.C. van Wachem** 1931, Dutch\*\* \*\*\*

**Chairman**

Member of the Supervisory Board since 1993;  
third term expires in 2005

Former Chairman of the Committee of Managing Directors of the Royal Dutch/Shell Group and currently Chairman of the Supervisory Board of Royal Dutch Petroleum Company; also member of the Supervisory Boards of Akzo Nobel, BMW and Bayer, and member of the Board of Directors of IBM, ATC and Zürich Financial Services



**W. de Kleuver** 1936, Dutch\* \*\*\*

**Vice-Chairman and Secretary**

Member of the Supervisory Board since 1998;  
first term expires in 2002

Former Executive Vice-President of Royal Philips Electronics and currently member of the Supervisory Board of HBG



**Prof. K.A.L.M. van Miert** 1942, Belgian\*

Member of the Supervisory Board since 2000;

first term expires in 2004

Former Vice-President of the European Commission and currently President of Nyenrode University, member of the Supervisory Boards of Walters Kluwer, RWE, DHV, Agfa Gevaert and De Persgroep and member of the Advisory Boards of Goldman Sachs, Rabobank, Guidant Europe and Eli Lilly



**L. Schweitzer** 1942, French

Member of the Supervisory Board since 1997;  
second term expires in 2005

Chairman and Chief Executive Officer of Renault and member of the Boards of Banque Nationale de Paris, Electricité de France and Volvo



**Sir Richard Greenbury** 1936, British\*\*

Member of the Supervisory Board since 1998;  
first term expires in 2002

Former Chairman and Chief Executive Officer of Marks & Spencer and former director of Lloyds TSB, British Gas, ICI and Zeneca, and currently member of the Board of Electronics Boutique Plc



**J-M. Hessels** 1942, Dutch\*

Member of the Supervisory Board since 1999;  
first term expires in 2003

Former Chief Executive Officer of Royal Vindex KBB and currently Chairman of the Supervisory Board of Euronext and member of the Supervisory Boards of Laurus, Schiphol Group, Royal Vopak, Heineken and Fortis

\* Member of the Audit Committee

\*\* Member of the Remuneration Committee

\*\*\* Member of the Nomination and Selection Committee

# Report of the Supervisory Board

## General

The Supervisory Board, acting in the interests of the Company and the Philips Group, supervises and advises the Board of Management in performing its management tasks and setting the direction of the Group's business.

The Supervisory Board is empowered to recommend to the General Meeting of Shareholders persons to be appointed as members of the Supervisory Board or the Board of Management. Major management decisions, including the strategy of the Group, require the approval of the Supervisory Board. The Supervisory Board determines the remuneration of the members of the Board of Management.

The Supervisory Board has three permanent committees that advise the full Board on certain matters: a Nomination and Selection Committee, a Remuneration Committee and an Audit Committee.

## Meetings of the Supervisory Board

The Supervisory Board met six times in the course of 2001, including a two-day meeting on strategy. The members of the Board of Management were present at the meetings of the Supervisory Board except in matters regarding the composition of the Supervisory Board, the Board of Management and the Group Management Committee, as well as the remuneration and performance of members of the Board of Management and the Group Management Committee. During the course of the year the Supervisory Board was informed and updated by the Board of Management on the course of business, important decisions and the strategy of the Philips Group.

## Composition and remuneration of the Supervisory Board

Members of the Supervisory Board are appointed by the General Meeting of Shareholders on the joint recommendation of the Supervisory Board and the Meeting of Priority Shareholders. The Supervisory Board aims for an appropriate combination of knowledge and experience among its members in relation to the global and multi-product character of the Company's businesses. Consequently the Board aims for an appropriate level of experience in marketing, manufacturing, financial, economic, social and legal aspects of international business and government and public administration. The Supervisory Board further aims to have available appropriate experience within Philips by having one or two former Philips executives as members on its Board. Members are appointed for fixed terms of four years and may be re-elected for two additional four-year terms.

The Supervisory Board currently consists of six members. At the General Meeting of Shareholders held on March 29, 2001, Mr W. Hilger retired from the Supervisory Board as a consequence of reaching the statutory age limit in 2001, while Messrs L.C. van Wachem and L. Schweitzer were re-elected.

At the 2002 Annual General Meeting of Shareholders, the present terms of Messrs W. de Kleuver and Sir Richard Geenbury end. In view of the knowledge, experience and contribution both members bring to the Board, we, in agreement with the Meeting of Priority Shareholders, will make a proposal at the General Meeting of Shareholders to be held on March 28, 2002 to re-elect Messrs De Kleuver and Greenbury.

The remuneration of the members of the Supervisory Board is determined by

the General Meeting of Shareholders of the Company. The Supervisory Board determines the additional remuneration for its chairman and the members of its committees. Since 1998, the remuneration is EUR 40,840 per year for members of the Supervisory Board and EUR 74,874 for the chairman. For each committee membership the remuneration is EUR 4,538 per year; details are disclosed on page 108 of the separate booklet entitled 'Financial Statements and Analysis'.

#### **Selection and nomination of members of the Supervisory Board, the Board of Management and the Group Management Committee**

The Supervisory Board and the Meeting of Priority Shareholders jointly recommend individuals to be elected by the General Meeting of Shareholders as members of the Supervisory Board and of the Board of Management. Under its rules of procedure, the Supervisory Board appoints members of the Group Management Committee who are not members of the Board of Management. All such resolutions are adopted upon the advice of the Nomination and Selection Committee consisting of the Chairman, Vice-Chairman and Secretary of the Supervisory Board (ex officio).

Mr C. Boonstra retired as President and Chairman of the Board of Management on April 30, 2001. Appointed by the General Meeting of Shareholders on March 29, 2001, Mr G.J. Kleisterlee succeeded Mr Boonstra on April 30, 2001. Mr A. Baan retired as Executive Vice-President and member of the Board of Management with effect from March 30, 2001. Mr J.W. Whybrow will retire, as planned, as Executive Vice-President and member of the Board of Management on April 1, 2002. The Supervisory Board is extremely grateful to Mr Whybrow for his almost 30 years of excellent service to Philips. In agreement with the Meeting of Priority Shareholders the Supervisory Board will make a proposal at the General Meeting of Shareholders to appoint Messrs A. Huijser and G.H. Dutiné as members of the Board of Management and Executive Vice-Presidents. Mr Huijser has been appointed Chief Technology Officer with effect from May 1, 2001 and is a member of the Group Management Committee, Senior Vice-President and CEO of Philips Research. Mr Dutiné, succeeding Mr Whybrow, has over twenty years' managerial experience in international business environments. He is a former Vice-President of the Telecom Board Committee of Alcatel, Chairman of Alcatel Deutschland GmbH and Area President of Alcatel for Central & Eastern Europe. In addition to his current responsibilities as Chief Financial Officer, the Supervisory Board has appointed Mr J.H.M. Hommen as Vice-Chairman of the Board of Management with effect from April 1, 2002. Mr D. Hamill and Mr S. McGregor have been appointed as members of the Group Management Committee and Senior Vice-Presidents with effect from May 1, 2001 and January 1, 2002, respectively.

#### **Remuneration of the Board of Management**

The remuneration of the members of the Board of Management is determined by the Supervisory Board on the advice of the Remuneration Committee of the Supervisory Board. The members of the Remuneration Committee are listed on page 60. The President is responsible for providing necessary



benchmark information and proposals, except regarding his own remuneration, to the Remuneration Committee.

#### General remuneration policies

The objective of the remuneration policy for members of the Board of Management is in line with that for Philips Executives throughout the Philips Group: to focus them on improving the performance of the Company and enhancing the value of the Group, to motivate and retain them, and to be able to attract other highly qualified executives to enter into the service of Philips, when required.

In determining the remuneration policy, the Remuneration Committee ensures that a competitive remuneration package for Board-level executive talent is maintained and benchmarked with other multinational companies operating in global markets. For that purpose, benchmarks are carried out each year with Dutch and other European companies of comparable size, complexity and international scope. Additional market data is provided by a number of independent external advisers. In the case of the appointment of non-European members of the Board of Management, the Remuneration Committee may apply a broader benchmark with non-European data.

In order to link executive remuneration strongly to the performance of the Company, the remuneration package includes a significant variable part in the form of an annual cash bonus incentive and a long-term incentive in the form of stock options, the base salary being the smaller part of the total potential remuneration.

#### Base salary

Base salaries are based on a function-related salary system. When appointed, an individual Board member's base salary will usually be well below the maximum function-related salary. Normally (and subject to decision by the Supervisory Board) the base salary will reach the maximum function-related salary level over a 3-year period from appointment. In line with market developments shown by benchmark studies, the maximum function-related salary levels in 2001 have been increased by 3.5% compared with 2000. In 2001, the (maximum) function-related salary of the President/CEO was EUR 986,972; the (maximum) function-related salary of an Executive Vice-President was EUR 635,292. The individual salary levels are shown in the table on page 106 of the separate booklet entitled 'Financial Statements and Analysis'. Adjustment of individual salaries is influenced by the (annual) adjustment, if any, of the function-related salary levels and the progress to the (maximum) function-related salary level where this has not yet been reached.

#### Annual cash bonus

Each year, a variable cash bonus can be earned, based on the achievement of specific realistic, but stretched, targets. Bonus targets are set at a challenging level, taking into account general trends in the relevant markets, and are partly linked to the total result of the Philips Group and partly to the areas of responsibility monitored by the individual member of the Board of Management. The bonus criteria and the targets for the members of the Board

of Management are determined annually at the beginning of the year by the Remuneration Committee on behalf of the Supervisory Board and are strongly linked to the Company's financial performance and the creation of shareholder value.

In principle, the maximum cash bonus achievable is 60% of the annual base salary. The Remuneration Committee may decide to grant a higher bonus percentage if exceptional targets are met. The bonus pay-out in any year relates to the achievement of the preceding financial year versus agreed targets. As a result, bonuses paid in 2001 relate to the salary levels and the (record) performance in the year 2000. Similarly, the bonuses payable in 2002 will be calculated on the basis of the 2001 annual results and will thus lead to a substantially lower bonus pay-out compared to 2001.

#### Stock options as long-term incentive

Stock options are granted to members of the Board of Management under the Philips stock option plans applicable to Philips Executives in general. These plans further align the interests of management and shareholders. The Supervisory Board has the discretionary power to grant Royal Philips Electronics stock options to members of the Board of Management. The stock option plans are approved each year by the Supervisory Board. In 2000 and 2001, 50% of the granted stock options were awarded as fixed options and 50% as performance-related options, linked to the long-term performance of the Company relative to a defined group of peer companies. As such a scheme was complex in execution and as performance-related vesting is uncommon in most countries in which we operate, the performance-related vesting of stock options has been changed, with effect from 2002, to a performance-related granting: the number of stock options to be granted as from 2002 is dependent on the performance of the Company in the preceding three years. For details of the plan, see pages 83-87 of the separate booklet entitled 'Financial Statements and Analysis'.

#### Pensions

The pensions of members of the Board of Management are funded by the Stichting Philips Pensioenfond (the 'Philips Pension Fund') of the Netherlands. The conditions contained in the by-laws of the Philips Pension Fund apply, with the proviso that the pensionable age – from the point of view of pension accrual – has been set at 60. If members of the Board of Management continue in the employment of the Company after the age of 60, the pension payments are postponed accordingly, as provided for in the Pension Fund by-laws. Because the retirement age is different from the date of commencement of the state pension, the pension scheme provides for a bridging payment in order to compensate for the adverse effect. The Board of Management members' own contribution comprises 4% of EUR 61,691 and 6% of the difference between the gross pensionable salary minus the franchise and the above-mentioned amount of EUR 61,691. A different arrangement resulting in additional pension benefits may apply in some cases as a result of past policies.

#### Additional arrangements

In addition to the main conditions of employment, a number of additional arrangements apply to members of the Board of Management. These additional arrangements, such as expense and medical cost allowances, accident insurance and company car arrangements, are broadly in line with those for Philips Executives in the Netherlands.

#### Contracts of employment

Members of the Board of Management have a contract of employment with the Company. The form of contract used for members of the Board of Management is in line with the standard form used for other Philips Executives.

In the event of disablement, members of the Board of Management are entitled to benefits in line with other Philips Executives in the Netherlands.

#### Review of financial statements

The Supervisory Board reviews the annual financial statements as presented by the Board of Management and upon approval will sign these documents. The Audit Committee, consisting of three members of the Supervisory Board, reviews the Company's annual and interim statements prior to publication and advises the Supervisory Board on the adequacy and appropriateness of internal control policies and internal audit programs and their findings. This includes such things as reviewing matters relating to accounting policies and compliance with accounting standards, compliance with statutory and legal requirements and regulations particularly in the financial domain. Important findings and identified risks are examined thoroughly in order to allow appropriate measures to be taken. The Committee also considers the appointment of the external auditors and their report with respect to the annual financial statements. It also advises on the Supervisory Board's statement to shareholders in the annual accounts. The Company's external auditors attended all Committee meetings in 2001.

#### 2001 financial statements

The financial statements of Koninklijke Philips Electronics N.V. for 2001, as presented by the Board of Management, have been audited by KPMG Accountants N.V., independent public auditors. Their report appears on page 105 of the separate booklet entitled 'Financial Statements and Analysis'. We have approved these financial statements.

We recommend to shareholders to adopt the 2001 financial statements as presented in the full Annual Report for the year 2001. We likewise recommend to shareholders to adopt the proposal of the Board of Management, approved by the Supervisory Board and the Meeting of Priority Shareholders, to make a distribution to shareholders of EUR 0.36 per common share from the other reserves.

February 5, 2002

*The Supervisory Board*

## Selected Financial Information

### Introduction

This Management Report and the separate booklet entitled 'Financial Statements and Analysis' together comprise the full Annual Report 2001 of Royal Philips Electronics. Selected Financial Information is derived from the Philips Group's full annual financial statements including notes as reported in the separate booklet entitled 'Financial Statements and Analysis'. That separate booklet also contains a comprehensive Operating and Financial Review and Prospects, additional financial information and further statutory and other information. For a full understanding of the results of the Group and the state of affairs, both booklets should be consulted.

The following Selected Financial Information should be read in conjunction with the Report on the performance of the Philips Group set out earlier in this Management Report.

### Auditors' report

We have audited the accompanying 2001 selected financial information of Koninklijke Philips Electronics N.V. appearing on pages 67 to 69. This information is derived from the 2001 financial statements of Koninklijke Philips Electronics N.V. as audited by us. We issued an unqualified auditors' report on those financial statements on February 5, 2002.

This selected financial information is the responsibility of the Company's management. Our responsibility is to express an opinion on this information based on our audit.

In our opinion this selected financial information corresponds in all material respects with the financial statements from which it is derived.

For a more comprehensive view of the financial position and results of the Company and the scope of our audit, the selected financial information should be read in conjunction with the full financial statements from which it is derived and the auditors' report we issued thereon.

Eindhoven, February 5, 2002

*KPMG Accountants N.V.*

### Accounting policies

The consolidated financial statements are prepared on a basis consistent with generally accepted accounting principles in the Netherlands (Dutch GAAP). Historical cost is used as the measurement basis unless otherwise indicated.



# Condensed statements of income of the Philips Group for the years ended December 31

in millions of euros unless otherwise stated

	2001	2000
Sales	32,339	37,862
Cost of sales:		
- amortization of goodwill and other intangibles	(371)	(263)
- other costs of sales	(22,814)	(25,579)
	(23,185)	(25,842)
<b>Gross income</b>	<b>9,154</b>	<b>12,020</b>
Selling expenses	(5,027)	(4,960)
General and administrative expenses	(1,230)	(1,298)
Research and development expenses	(3,312)	(2,766)
Write-off of acquired in-process R&D	(106)	(44)
Restructuring and impairment charges	(1,093)	(197)
	(10,768)	(9,265)
Other business income	243	1,526
<b>Income (loss) from operations</b>	<b>(1,371)</b>	<b>4,281</b>
Financial income and expenses:		
- interest	(391)	(167)
- other	(524)	2,155
	(915)	1,988
<b>Income (loss) before taxes</b>	<b>(2,286)</b>	<b>6,269</b>
Income taxes	421	(570)
<b>Income (loss) after taxes</b>	<b>(1,865)</b>	<b>5,699</b>
Results relating to unconsolidated companies:		
- income (loss) excluding amortization of goodwill and other intangibles	(387)	4,094
- amortization of goodwill and other intangibles	(367)	(124)
	(754)	3,970
<b>Group income (loss)</b>	<b>(2,619)</b>	<b>9,669</b>
Minority interests	15	(67)
<b>Net income (loss)</b>	<b>(2,604)</b>	<b>9,602</b>
Weighted average number of common shares outstanding (after deduction of treasury stock) during the year (in thousands)	1,278,077	1,312,859
<b>Basic earnings per common share in euros:</b>		
Net income (loss)	(2.04)	7.31
<b>Diluted earnings per common share in euros:</b>		
Net income (loss)	(2.04)	7.24
Dividend paid per common share in euros (from prior-year profits)	0.36	0.30

# Condensed balance sheets of the Philips Group as of December 31

in millions of euros

The consolidated balance sheets are presented before appropriation of profit

	2001	2000
<b>Current assets</b>		
Cash and cash equivalents	890	1,089
Securities	130	111
Receivables	6,154	6,806
Inventories	4,290	5,279
Total current assets	11,464	13,285
<b>Non-current assets</b>		
Unconsolidated companies	5,632	5,328
Other non-current financial assets	2,789	3,747
Non-current receivables	3,582	2,713
Property, plant and equipment	7,718	9,041
Intangible assets – net	7,269	4,427
Total non-current assets	26,990	25,256
<b>Total</b>	<b>38,454</b>	<b>38,541</b>
<b>Current liabilities</b>		
Accounts and notes payable	3,243	4,255
Accrued liabilities	4,137	3,701
Short-term provisions	1,456	969
Other current liabilities	813	862
Short-term debt	1,271	1,743
Total current liabilities	10,920	11,530
<b>Non-current liabilities</b>		
Long-term debt	6,595	2,284
Long-term provisions	2,284	2,522
Total non-current liabilities	8,879	4,806
<b>Group equity</b>		
Minority interests	202	469
Stockholders' equity	18,453	21,736
<b>Total</b>	<b>38,454</b>	<b>38,541</b>

# Condensed statements of cash flows of the Philips Group for the years ended December 31

in millions of euros

	2001	2000
<b>Cash flows from operating activities:</b>		
<b>Net income (loss)</b>	(2,604)	9,602
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,797	2,320
Net gain on sale of investments	(378)	(6,384)
(Income) loss from unconsolidated companies (net of dividends received)	676	(1,187)
Minority interests (net of dividends paid)	(21)	56
Decrease (increase) in working capital	1,080	(1,069)
Increase in non-current receivables	(874)	(510)
Increase in provisions	287	386
Other items	285	(218)
<b>Net cash provided by operating activities</b>	<b>1,248</b>	<b>2,996</b>
<b>Cash flows from investing activities:</b>		
Purchase of intangible assets (software)	(234)	(140)
Capital expenditures on property, plant and equipment	(2,143)	(3,170)
Proceeds from disposals of property, plant and equipment	221	178
(Purchase) proceeds from the sale of securities available for sale	(1)	848
Purchase of other non-current financial assets	(76)	(560)
Proceeds from other non-current financial assets	550	63
Purchase of businesses	(3,636)	(3,209)
Proceeds from sale of interests in businesses	755	3,586
<b>Net cash used for investing activities</b>	<b>(4,564)</b>	<b>(2,404)</b>
<b>Cash flows before financing activities</b>	<b>(3,316)</b>	<b>592</b>
<b>Cash flows from financing activities:</b>		
(Decrease) increase in short-term debt	(73)	734
Principal payments on long-term debt	(554)	(325)
Proceeds from issuance of long-term debt	4,580	203
Treasury stock transactions	(336)	(578)
Capital repayment to shareholders	–	(1,673)
Dividends paid	(458)	(399)
<b>Net cash provided by (used for) financing activities</b>	<b>3,159</b>	<b>(2,038)</b>
<b>Cash used for continuing operations</b>	<b>(157)</b>	<b>(1,446)</b>
Effect of changes in exchange rates and consolidations on cash positions	(42)	204
<b>Cash and cash equivalents at beginning of year</b>	<b>1,089</b>	<b>2,331</b>
<b>Cash and cash equivalents at end of year</b>	<b>890</b>	<b>1,089</b>

# The Philips Group in the last eight years\*

all amounts in millions of euros unless otherwise stated

Due to factors such as consolidations and divestments, the amounts, percentages and ratios are not directly comparable.

## General data

	2001	2000	1999	1998	1997	1996	1995	1994
Sales	32,339	37,862	31,459	30,459	29,658	27,094	25,259	23,768
Percentage increase over previous year	(15)	20	3	3	9	7	6	2
Income (loss) from continuing operations	(2,604)	9,602	1,804	541	1,231	126	971	683
Discontinued operations	—	—	—	5,054	263	202	247	281
Net income (loss)	(2,604)	9,602	1,799	6,053	2,602	(268)	1,143	964
Turnover rate of net operating capital	2.15	3.16	3.14	2.91	2.84	2.70	2.88	2.95
Total employees at year-end (in thousands)	189	219	227	234	252	250	253	241
Salaries, wages and social costs paid	8,100	8,456	8,016	8,209	8,261	8,083	7,363	7,031

## Income

Income (loss) from operations	(1,371)	4,281	1,751	685	1,714	422	1,350	1,227
As a % of sales	(4.2)	11.3	5.6	2.2	5.8	1.6	5.3	5.2
As a % of net operating capital (RONA)	(9.1)	35.7	17.5	6.5	16.4	4.2	15.4	15.2
Income taxes	421	(570)	(336)	(41)	(276)	7	(74)	(135)
As a % of income before taxes	18	9	19	11	20	(40)	7	16
Income (loss) after taxes	(1,865)	5,699	1,447	332	1,119	25	964	696
As a % of sales	(5.8)	15.1	4.6	1.1	3.8	0.1	3.8	2.9
Income (loss) from continuing operations	(2,604)	9,602	1,804	541	1,231	126	971	683
As a % of stockholders' equity (ROE)	(12.8)	53.5	12.6	5.1	15.9	1.9	15.8	12.5
Per common share	(2.04)	7.31	1.31	0.38	0.88	0.09	0.71	0.51
Net income (loss)	(2,604)	9,602	1,799	6,053	2,602	(268)	1,143	964
Per common share	(2.04)	7.31	1.31	4.20	1.86	(0.20)	0.84	0.72
Dividend paid per common share (from prior-year profit distribution)	0.36	0.30	0.25	0.23	0.18	0.18	0.14	0.06

\* 1997 and prior years have been restated to reflect the sale of PolyGram N.V. in 1998 and to present the Philips Group accounts on a continuing basis.

### Definitions

Net operating capital:	intangible assets (excl. goodwill unconsolidated companies), property, plant and equipment, non-current receivables and current assets excl. cash and cash equivalents, securities and deferred tax positions, after deduction of provisions and other liabilities
RONA:	income from operations as a % of average net operating capital
ROE:	income from continuing operations as a % of average stockholders' equity
Net debt:	long-term and short-term debt net of cash and cash equivalents
Net debt: group equity ratio:	the % distribution of net debt over group equity plus net debt
Average number of outstanding shares:	weighted average number of outstanding common shares based on monthly positions during the reporting year

The financial statements have been prepared in euros. Amounts previously reported in Dutch guilders are reported in euros using the irrevocably fixed conversion rate which became effective on January 1, 1999 (EUR 1 = NLG 2.20371).



## Capital employed

	2001	2000	1999	1998	1997	1996	1995	1994
Cash and cash equivalents	890	1,089	2,331	6,553	1,397	785	932	940
Securities	130	111	1,523	–	–	–	–	–
Receivables	6,154	6,806	6,453	5,442	5,464	5,369	4,890	4,567
Inventories	4,290	5,279	4,566	4,274	4,522	4,334	5,083	4,330
Current assets	11,464	13,285	14,873	16,269	11,383	10,488	10,905	9,837
Non-current financial assets	8,421	9,075	2,431	2,836	1,451	1,618	1,358	1,257
Net assets discontinued operations	–	–	–	–	1,482	1,198	1,013	901
Non-current receivables	3,582	2,713	2,326	1,920	1,858	1,662	1,413	1,397
Property, plant and equipment (book value)	7,718	9,041	7,332	6,574	6,935	6,719	6,094	5,599
Intangible assets (book value)	7,269	4,427	2,822	554	213	222	198	105
Non-current assets	26,990	25,256	14,911	11,884	11,939	11,419	10,076	9,259
Total assets	38,454	38,541	29,784	28,153	23,322	21,907	20,981	19,096
Property, plant and equipment:								
Capital expenditures for the year	2,143	3,170	1,662	1,634	1,627	2,185	2,127	1,535
Depreciation for the year	1,969	1,789	1,548	1,615	1,492	1,437	1,218	1,270
Capital expenditures : depreciation	1.1	1.8	1.1	1.0	1.1	1.5	1.7	1.2
Inventories as a % of sales	13.3	13.9	14.5	14.0	15.2	16.0	20.1	18.2
Outstanding trade receivables, in months' sales	1.5	1.5	1.4	1.3	1.3	1.3	1.5	1.5

## Financial structure

Other current liabilities	8,193	8,818	8,262	6,779	6,328	5,768	5,643	5,373
Debt	7,866	4,027	3,314	3,587	4,030	5,855	4,756	3,875
Provisions	3,740	3,491	3,118	2,985	3,251	3,420	3,460	3,566
Total provisions and liabilities	19,799	16,336	14,694	13,351	13,609	15,043	13,859	12,814
Issued, paid-up capital	263	263	339	1,672	1,655	1,600	1,566	1,536
Surplus and reserves	18,190	21,473	14,418	12,888	7,499	4,985	5,060	4,410
Stockholders' equity	18,453	21,736	14,757	14,560	9,154	6,585	6,626	5,946
Minority interests	202	469	333	242	559	279	496	336
Group equity	18,655	22,205	15,090	14,802	9,713	6,864	7,122	6,282
Total equity and liabilities	38,454	38,541	29,784	28,153	23,322	21,907	20,981	19,096
Net debt : group equity ratio	27:73	12:88	6:94	*	21:79	42:58	35:65	32:68
Stockholders' equity per common share	14.48	16.93	11.08	10.09	6.39	4.74	4.85	4.41
Market price per common share at year-end	33.38	39.02	33.75	14.30	13.80	7.94	6.58	5.83

\* Not meaningful: net cash in 1998 exceeded the debt level

## Shareholder information

### Reporting

All quarterly and annual reports for the last five years

### Presentations to analysts

All presentations to analysts and shareholders are listed here.

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### Discover our divisions

A background presentation on each of the divisions can be downloaded. In addition, there are links to the divisional websites.

### Shareholder information

Here, information is given on various subjects such as the General Meeting of Shareholders, services for US shareholders and the Shareholders' Communication Channel.

### Environment and ethical issues

Environment  
General Business Principles  
Child and forced labor  
Health and safety  
Military and defense contracts  
Political payments  
OECD Guidelines

### Corporate information

General information on Philips can be found here: the Philips boards, dividend history, Articles of Association and the Governance model.

### Important dates

The shareholder calendar giving all dates for analyst meetings, earnings releases and shareholder meetings

## Payment of distribution to shareholders

Shares of Koninklijke Philips Electronics N.V. ('Royal Philips Electronics') will be listed ex-dividend as of April 2, 2002. In compliance with the listing requirements of the New York Stock Exchange and the stock market of Euronext Amsterdam, the record dates will be April 4, 2002 for holders of American shares of New York Registry, and March 28, 2002 for other Philips shares.

The distribution in cash as proposed to the General Meeting of Shareholders will be payable as of April 8, 2002 to all shareholders. The distribution to holders of American shares will be made in USD at the USD/EUR rate at the close of business of Euronext Amsterdam on April 4, 2002.

## Important dates

Record date Annual General Meeting of Shareholders	March 21, 2002
Annual General Meeting of Shareholders	March 28, 2002
First quarterly report 2002	April 16, 2002
Second quarterly report 2002	July 16, 2002
Third quarterly report 2002	October 15, 2002
Publication of 2002 results	February 11, 2003*
Publication of the Annual Report 2002	February 11, 2003*
Annual General Meeting of Shareholders	March 27, 2003*
First quarterly report 2003	April 15, 2003*
Second quarterly report 2003	July 15, 2003*
Third quarterly report 2003	October 14, 2003*

\* These dates are subject to final confirmation.

**Copies of Annual Report 2001**

Non-US shareholders and other non-US interested parties can obtain copies of the Annual Report 2001 free of charge from:

Royal Philips Electronics

Annual Report Office

P.O. Box 218

5600 MD Eindhoven, The Netherlands

Fax: 31-40-2786436

Holders of shares of New York Registry and other interested parties in the USA can obtain, free of charge, copies of the Annual Report 2001 from the Transfer and Register Agent:

Citibank Shareholder Services

P.O. Box 2502

Jersey City, New Jersey 07303-2502

Telephone: 877-CITI-ADR (toll-free)

Fax: 201-324-3284

E-mail: [citibank@em.fcncd.com](mailto:citibank@em.fcncd.com)

Internet address:

[www.citibank.com/corpbank/adr](http://www.citibank.com/corpbank/adr)

The Annual Report on Form 20-F is filed electronically with the United States Securities and Exchange Commission.

The Annual Report 2001 is also available in the original Dutch version, which is the authentic text.

**Information sources**

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US shareholders should direct communications concerning share transfers, lost certificates, dividends and change of address to Citibank (see above). Non-US shareholders should contact:

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